# 1986 UNITED STATES-CANADA MEMORANDUM OF UNDERSTANDING ON SOFTWOOD LUMBER

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## HEARING

BEFORE THE

## SUBCOMMITTEE ON REGULATION, BUSINESS OPPORTUNITIES, AND ENERGY

OF THE

## COMMITTEE ON SMALL BUSINESS
## HOUSE OF REPRESENTATIVES

ONE HUNDRED SECOND CONGRESS

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# 1986 UNITED STATES-CANADA MEMORANDUM OF UNDERSTANDING ON SOFTWOOD LUMBER

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FRIDAY, FEBRUARY 22, 1991

House of Representatives,
Subcommittee on Regulation, Business
Opportunities, and Energy,
Committee on Small Business,
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10:00 a.m., in room 2123, Rayburn House Office Building, Hon. Ron Wyden (chairman of the subcommittee) presiding.

Chairman **Wyden**. The subcommittee will come to order.

Today, the Subcommittee on Regulation will measure the effectiveness and future of the United States-Canada understanding on softwood lumber. This agreement, signed in 1986, has stood for more than 4 years, now, as the U.S. lumber industry's principal protection against the dumping of Canadian Government-subsidized wood products in the U.S. domestic market.

Should anyone think this agreement to be just so much trade bureaucracy wheel-spinning, consider some numbers from the decade just prior to the MOU's signing.

Roughly, from the mid-1970's to the mid-1980's, U.S. timber companies shut down more than 600 domestic timber mills and eliminated more than 30,000 timber jobs. Many of those closures occurred in the Pacific Northwest.

In that same period, the Canadians' share of the U.S. market almost doubled, finally reaching approximately one-third of all lumber products sold in this country.

The U.S. wood products industry was hemorrhaging, and Canadian timber companies—aided by the stewards of Canadian public forests—literally held the straight razor.

This was not simply the result of economically inevitable belt-tightening, modernization, and labor-saving efficiencies. Consider the price Canadian wood products companies were paying for their timber. Credible data suggests that Government-owned timber in the Canadian Provinces sold for as little as one-tenth the price of similar standing timber in the United States.

According to public record data gathered by the subcommittee staff, the cost advantage remains impressive. Last year, for example, public timber purchasers in western Oregon paid an average of $198 per 1,000 board feet. Purchasers of very similar timber in western British Columbia, however, paid only $44 per 1,000 board feet.

The Chair points out that we are making very close comparisons in terms of trees and terrain.

Saying that Canadian politicians give away public timber to powerful Canadian timber companies may be too strong. Clearly, the Canadian timber companies get a very sweet deal at the expense of the Canadian public, and considerable pain of U.S. timber companies and employees.

The administration needs to answer a key question, today. Given the wide disparity—a gap which is getting bigger, not smaller—between Pacific Northwest and British Columbian timber values, has the MOU been enough to resolve the basic problem?

In the Chair's view, more remains to be done.

The 1986 MOU was our effort to reach a more level playing field. The Canadians—faced with the threat of a countervailing duty on a number of Canadian imports to the United States—agreed to allow Provincial Governments to collect up to a 15-percent export fee on all finished wood products bound for U.S. markets. That fee could be adjusted downward as Canadian stumpage—the rate buyers pay for standing timber—went up toward a true market level.

In Canada, this has been no easy task. In the United States, true market value is established through competitive bidding for both public and private timber. Across the border, however, prices are set administratively, with preferences traditionally allowed to certain big timber operators.

The result: High prices for timber in the United States under a free market system, and Government-subsidized, under-value prices in Canada to support certain timber companies.

If such a system had no impact on the United States, I wouldn't quarrel with it. But the fact is that Canadians over the last 30 years, beginning at a time when their U.S. market share was in the low single digits, have used this system to bludgeon our timber products industry.

Representatives from our own timber industry will testify, today, that the MOU has at least sealed some holes in the dike.

U.S. suppliers, under heavy pressure from subsidized Canadian imports, now see Canadian products priced at levels closer to true market value. While this has decreased the profitability of some of Canada's largest timber products companies, there is no indication that Canadian suppliers or their workers are being put out of business by this agreement.

Ironically, one of the big winners in this agreement turned out to be Canadian Provincial Governments, some of whom have collected hundreds of millions of dollars in fee revenues.

For these Provinces, this has truly been a "pay me now or pay me later" situation.

But the Canadian timber companies, who have always loathed the agreement and the price restrictions it places on U.S. marketing programs, have now turned up the heat on both Provincial and Federal officials.

They want the agreement dumped, and they have found powerful and sympathetic listeners in both the Provincial capitals and in Ottawa. Members of Prime Minister Mulroney's cabinet have argued both on the floor of the Parliament and in the Canadian press that the MOU must go. Representatives of the Canadian industry have contacted my staff, suggesting that the official abrogation of the agreement could come at any time.

So, while an oversight hearing on the performance of this agreement after 4 years is appropriate in any case, the timeliness of this session is particularly significant.

The Chair believes that there is a solid prospect that the Canadian Government will shortly demand either significant changes to, or the elimination of the agreement. There is a similar prospect that if the U.S. Government does not agree to these new demands, the Canadians will unilaterally abrogate the MOU.

The question then will be, what will be the U.S. response.

Former President Reagan said 4 years ago that he would use section 301 of the trade law to enforce this agreement. Levy the fee, he said, or face the countervailing duty.

The present administration has not gone this far. Will the Bush administration live up to the promise made by the Reagan administration?

What of the Canadian political climate, today? Is the repeal of the MOU inevitable?

Today, we will hear from economists, foresters, and timber industry leaders on the past, present, and future of this agreement. We will also take testimony from representatives of the Commerce Department's International Trade Administration, the chief enforcers of the MOU.

The Chair points out for the record that the subcommittee invited testimony from several Canadian witnesses. Those invitations were sent to Mike Apsey of the Council of Forest Industries of British Columbia, Tom Buell of the Canadian Forest Industries Council, and Claude Richmond, minister of forests for the Province of British Columbia. These individuals were not picked at random. They represent the most vocal critics of the MOU. Their views would have been of interest and value. Unfortunately, all three turned down our invitation.

[Mr. Wyden's opening statement may be found in the appendix.]

The Chair is pleased that a number of our colleagues are here, particularly my colleague from the adjoining district, Mike Kopetski who is going to be an outstanding addition, I think, to the Northwest delegation. We are happy to have him with us.

Several colleagues from the State of Washington have worked very hard on these issues. Let me recognize Mr. Kopetski for an opening statement, if he chooses.

Mr. Kopetski. Thank you, Mr. Chairman. I want to thank you for inviting me to participate in this hearing this morning. Although I am not a member of this committee, I am, like you, deeply concerned about the health of the timber- and lumber-processing industries in the Pacific Northwest. With the current slump in domestic forest products markets, we must concentrate our efforts to help these industries so vital to our economic well-being in any possible way.

Mr. Chairman, it is for this reason I can not think of a more important topic for a hearing than the issue before us today: The United States-Canada Memorandum of Understanding on Softwood Lumber. This MOU was negotiated in good faith in 1986 between the United States and Canada after decades of heavily subsidized Canadian lumber flooded American markets, causing U.S. lumber mills closures and sector-wide unemployment.

The agreement was designed to partially offset stumpage rates, the price Canadian manufacturers paid for standing, Government-owned timber. This timber was, and in some cases continues to be, priced dramatically below market rates paid by U.S. timber companies buying trees through competitive bidding.

The MOU, among other things, requires the Canadian Provincial Governments to assess an export tax of up to 15 percent on finished forest products to the United States. Now, after 5 years of enforcement, the Canadian timber companies are starting to make headway on having the export tax dropped.

Canadian Provincial and Federal officials, including senior members of the Mulroney cabinet, have stated that they plan to abrogate the agreement in the near future. With our domestic timber producers already devastated by soft markets and low housing starts, the implications of the Canadians backing out of the MOU could be disastrous for the Pacific Northwest.

Mr. Chairman, I understand that this committee has received reports that the Bush administration may let the Canadian Government unilaterally break this agreement without imposing trade sanctions due to the Canadian support of Operation Desert Storm. While the administration appreciates Canada's strong showing in the gulf, it should not impact trade agreements.

The administration must not let our allies take advantage of the need to keep a strong coalition together in support for Operation Desert Storm in Riyadh, Saudi Arabia interfere with our need to keep American mills in Estacada, Oregon operating and workers employed.

Mr. Chairman, there are many other important trade issues before us this session—GATT negotiations, Most Favored Nation status for China, and the United States-Mexico Free Trade Agreement of which the United States and Canada are partners. I hope this administration will not trade the economic well being of America's small businesses for Persian Gulf support.

Mr. Chairman, I want to commend you for holding this hearing. I look forward to working with you and the entire Northwest delegation in helping the forest-products industries weather the current market problems.

Thank you very much.

[Mr. Kopetski's opening statement may be found in the appendix.]

Chairman Wyden. I want to thank my colleague. His statement is very helpful, and we invite you to participate to the extent you can this morning.

We are also very pleased to have two other outstanding colleagues from the Northwest, Congresswoman Unsoeld and Congressman Morrison. Why don't we call both of you up together. It is a pleasure to have you both, and I know that both of you have labored very long and hard on timber issues, as well as a variety of issues.

Going in the order of seniority, we will recognize Mr. Morrison first for any comments he would like to make, and then our friend from the other side of the river, Congresswoman Unsoeld.

Sid, we welcome you, and it is always a pleasure to be on a team concerning forestry issues with you.

Mr. **Morrison**. Thank you, Mr. Chairman.

Again, let me associate myself with the remarks that have been shared from the podium with us, and of course thank you for your leadership, through this subcommittee, in taking a look at this issue. It is a most important time for us.

I do not have a prepared statement, but I certainly have some feelings that relate to this issue, and a record of participation, including spending quite a bit of time before the Memorandum of Understanding was reached with our good friends in Canada, visiting with them in their own country, looking at their industry, and trying to grasp the differences between United States and Canadian involvement in the timber industry.

I came away from those meetings with better understanding, but with even a stronger feeling that the Memorandum of Understanding was essential to level the field in competition between the two areas. That is why I am particularly distressed now that we are hearing, and as you have heard, that they don't like it, and that they are getting some governmental support, perhaps as a guilt reaction to the United States-Canada Free Trade Agreement or something.

But I think there should be no linkage as far as this issue is concerned. It should be considered as a timber industry effort that I think has achieved at least a better degree of parity between the two countries.

So, again, I commend you for hearing this. It is sort of an early warning, and I certainly will do everything I can in working with the Forestry 2000 Task Force and our colleagues in the Northwest, and working with the Bush administration, and hoping they will understand that this is a good package, and that the position that President Reagan took in support of it is a position that should be maintained by this administration.

Thank you for the opportunity.

Chairman **Wyden**. Well, Sid, thank you very much, and we hope that these are just the early warnings. The staff just brought a story that I guess is running on some wire service up in Canada that says, "Ottawa wants to scrap a 15-percent tax on Canadian softwood lumber exports, Crosby said Thursday." So, clearly, they are upping the ante, and I am real pleased to have a chance to work with you and our other colleagues in the delegation. You are taking the lead in terms of the Washington delegation, trying to fashion an overall response to these issues. It is good to have bipartisan concern in our delegation.

Mr. **Morrison**. Perhaps one additional comment is in order. My understanding is at least our colleagues in British Columbia are going through some readjustments. They are losing some mills as well.

We, certainly, now in the Northwest, as the four of us know better than perhaps the other States, are going through some dramatic readjustments. The lack of housing starts has had its impact;

mills are closing. Even before we consider the impact of the Endangered Species Act, the spotted owl and the salmon potential listings could have a dramatic influence as well.

My recommendations would be that we get this period in front of us and see some stability in timber supply before we begin to play games with the trading relationship between the two countries.

Chairman Wyden. I think that is a point well taken and particularly when things are so volatile and unstable, as you say they are now. Now is not the time to make dramatic trade changes that could be devastating, particularly on our side of the border. Well said.

Congresswoman Unsoeld also is an activist on those important issues, and my friend from the other side of the river, the Vancouver Portland team. So, I am real pleased to have you, Jolene, and we will put your remarks in the record as well. We welcome any comments you would like to make.

Mrs. Unsoeld. Thank you, Mr. Chairman, for holding a hearing on this subject of such great import to the Northwest.

Briefly, I want to emphasize that it is imperative we remain united against efforts to eliminate the Memorandum of Understanding. Just as our neighbors to the north, we face a painful recession. Just as our neighbors to the north, our timber communities are suffering. But unlike our neighbors to the north, our lumber producers must compete aggressively at the bidding table if they hope to secure that ever-scarcer commodity, timber.

In too many instances, the United States has allowed itself to be pushed around when it comes to establishing trade relations. Our difficulty penetrating Japanese lumber markets is a perfect example. Yet, with the Memorandum of Understanding, we have actually forged a workable, relatively fair solution to a previously unfair situation in which a government was virtually giving its resources away. There is no way our companies, even though they are the most efficient in the world, can compete against corporations whose raw materials are heavily subsidized by their government.

Mr. Chairman, if any modifications to the Memorandum of Understanding are made, I ask that they be made to improve implementation and enforcement of the agreement, not to weaken it. We should remember that the Memorandum of Understanding has never fully leveled the playing field; a tremendous subsidy still exists.

In 1990, British Columbian producers were paying an average stumpage price of only $48 per 1,000 board feet, while my constituents in Western Washington paid $225 per 1,000 board feet. Clearly, Canadian subsidies are not the only, or even primary, factor in this disparity, but even on the Eastside Forests of Washington—which have not been as hard hit by spotted owl restrictions—our bidders paid $92 per 1,000 board feet, while purchasers across the border paid only $38 per 1,000 board feet.

The Memorandum of Understanding is working for American companies. While Canadian lumber producers still control over 26.7 percent of the U.S. market, they had 33 percent of our market in 1985, just before the Memorandum of Understanding went into place. U.S. exports to Canada have increased by 60 percent from 1986 to 1990.

Mr. Chairman, these are not the times to be renegotiating this historic agreement. Our communities are hurting from a reduced timber supply and a national recession. We can't ask them to make more sacrifices. Let's send a message to the administration to stay the course, hold firm to this agreement, and not let our struggling communities down.

Thank you, Mr. Chairman.

[Mrs. Unsoeld's opening statement may be found in the appendix.]

Chairman WYDEN. Well, Jolene, thank you for an excellent statement. It really does bring it into focus to have those dramatic figures that you have outlined in terms of your area.

Both of you have been very helpful. We welcome you if you care to come to this side of the dais and sit in. I know that all of us are waiting for the President's remarks in a little bit with respect to the Persian Gulf and your schedules are tight. We are looking forward to working closely with both of you, and just thank you very much for your very helpful remarks.

Mrs. UNSOELD. I will leave it in your good hands.

Chairman WYDEN. Our next panel, representing the International Trade Administration, Marjorie Chorlins, Deputy Assistant Secretary for Import Administration, and Mr. Joseph Spetrini, Deputy Assistant Secretary for Compliance. If you two would come forward.

Mr. KOPETSKI. Mr. Chairman, I do have the Northwest director of the Environmental Protection Agency waiting in my office. They are a very powerful agency, so I should go say hello.

Chairman WYDEN. I thank my colleague. It is very helpful to have your involvement, and I know that there is a lot going on today. I look forward to working with you.

Mr. KOPETSKI. I appreciate the fact that the urban legislator from Oregon is here for these committees and has a strong interest in these matters.

Chairman WYDEN. I thank my colleague, and we know that there are a lot of jobs all through the Northwest, and my colleague's points are very good ones. Thank you. All right.

Ms. Chorlins, Mr. Spetrini, it has always been the practice of this subcommittee to swear all witnesses who come before this subcommittee. Do either of you have any objections to being sworn as a witness?

Please rise and raise your hand.

[Witnesses sworn.]

Chairman WYDEN. We thank you both for your participation here. I would also like to note for the record that both Ms. Chorlins and Mr. Spetrini have been very helpful to us in getting this hearing off the ground and addressing these important issues. We want to thank you both personally for that assistance.

Let's begin with you, Ms. Chorlins. We will make your prepared remarks a part of the record in their entirety. Why don't you just proceed on the statement at the point that you see fit.

## TESTIMONY OF MARJORIE A. CHORLINS, DEPUTY ASSISTANT SECRETARY, IMPORT ADMINISTRATION, U.S. DEPARTMENT OF COMMERCE, ACCOMPANIED BY JOSEPH SPETRINI, DEPUTY ASSISTANT SECRETARY, COMPLIANCE, INTERNATIONAL TRADE ADMINISTRATION

Ms. **Chorlins**. Thank you, Mr. Chairman.

Chairman **Wyden**. Chairman Dingell always notes we have infernal mikes here.

Ms. **Chorlins**. Thank you, Mr. Chairman.

I would like to present the testimony on behalf of the Department of Commerce. In the interest of time, I will summarize my testimony.

First, I would like to thank you for the opportunity to testify before the subcommittee this morning on the United States-Canada softwood lumber MOU. I want to note at the outset that your personal interest, as well as the vigilant oversight by the subcommittee, and the interests of other Members of Congress in this matter have been, I think, important elements in buttressing our enforcement of the MOU thus far.

I know that you are particularly interested in the economic effects of the MOU. It is difficult to isolate the effects of the MOU on the price of Canadian lumber in the U.S. market because of the many supply and demand factors which affect price. However, I would like to point out that in the first quarter of 1987, the period immediately following the adoption of the MOU, the price of Canadian lumber in the U.S. market increased nearly 9 percent. These prices remained approximately constant through the third quarter of 1990, which is the period for which we have most recently collected and analyzed the data.

Import penetration of Canadian lumber has decreased from a high of 33 percent in 1985 to approximately 27 percent today. Most analysts agree that this drop in import penetration is due both to the implementation of the MOU and the strengthening of the Canadian dollar.

Since United States and Canadian manufacturers are essentially the sole suppliers to the American softwood lumber market, any fall in the Canadian import penetration rate logically results in an increase in market share for U.S. manufacturers. It is difficult to assess the effect of this fall in import penetration on the overall strength of the industry, but we do believe it has been beneficial.

It is important to recognize that the impact of the MOU is more far reaching than just in terms of its effect on price. The aim of the MOU, you will recall, was to offset subsidies and the resulting artificial cost advantage provided to the Canadian industry. We believe the MOU has achieved this goal.

At the time the MOU was signed, the export tax was adequate to offset the effect of subsidized Canadian lumber. Since then, we have monitored, and continue to monitor, policies in Canada to ensure that no new subsidies have been implemented and that the Federal and Provincial Governments in Canada have not instituted any measure that might otherwise offset or mitigate the effects of the MOU.

At this time, we believe no further action is necessary. Generally speaking, we would like to see Canada adopt an open and purely market-oriented system. If such a system were put into place, we would certainly welcome a discussion on possible changes to the MOU. But, absent a permanent market-oriented system in Canada, the U.S. Government remains firmly committed to the MOU and stands ready to take any action necessary and appropriate to enforce the terms of the agreement.

Events in Canada clearly suggest that the Government there is under increasing pressure to renegotiate or possibly scrap the MOU entirely. Mill closures, a stronger Canadian dollar, and recessionary forces in that economy have made the MOU an obvious target. These pressures are also likely to increase if the economic downturn continues for some time into the future. The Canadian lumber industry and certain Government officials, as you noted earlier, have stated publicly that economic conditions warrant certain changes to the agreement, if not its termination altogether. But the Government of Canada has not formally proposed any specific changes in the agreement.

Indeed, the article you referenced earlier, in which the Canadian Trade Minister was quoted, is, in fact, nothing new. For some time, we have heard tell of Canadian Government offerings expressing a desire to either renegotiate or eliminate the MOU, but no formal proposals have been forthcoming.

Although Canada's larger economic problems have affected its lumber industry, they clearly have not affected the subsidies which the MOU was designed to offset. Many of the underlying problems addressed by the MOU could, in fact, be eliminated if Canada would change from administratively determined lumber prices to those set by market competition.

We have not seen any evidence of such structural changes in Canada which might eliminate the need for the MOU. Therefore, we cannot contemplate its termination. As long as the MOU remains in effect, the U.S. Government will continue to enforce it vigorously.

Our monitoring and enforcement process centers on three main areas.

First, we hold regular consultations with the Government of Canada to review administration and enforcement of the agreement. In fact, we have quarterly consultations coming up with the Canadians next week on this matter. We use feedback from these meetings to tighten our monitoring activities.

Second, we maintain an extensive data monitoring system centered around the export notices required with each importation of covered lumber.

Finally, the third leg of our enforcement process involves physical review of the lumber shipments and their documentation at the time of entry. The Department of Commerce, in conjunction with the U.S. Customs Service, has sent teams to several major lumber importing ports on the border to check shipments and the accompanying documentation. These operations have generally shown that most Canadian softwood lumber producers are complying with the MOU reporting requirements. We have discovered some individual problems, and we continue to work with our Canadian counterparts to resolve them and to improve this aspect of compliance with the agreement.

To date, we believe Canada has been complying with the agreement, although this has required a high degree of vigilance on the part of the Department of Commerce.

At this point, Mr. Chairman, I would like to make mention of the lumber team at the Department of Commerce and commend them for their vigilance in enforcing this agreement. Mr. Spetrini and his staff have done a superior job, and I would like to note the members of the team—Paul McGarr, Mike Rollin, Anne Driscoll, Randall Edwards, Elizabeth Levi, and Bill Marsteller— for their efforts in this regard.

Generally speaking, we believe a more effective means of meeting the objectives of the MOU are through so-called replacement measures, whereby Provinces can offset part or all of the export tax. These replacement measures require less monitoring and enforcement than collection of an export tax as they apply equally to all lumber production rather than just that portion exported to the United States. This greatly reduces the opportunity for circumvention. In addition, replacement measures help to set the stage for potential elimination of the subsidies which generated the need for the MOU in the first place. Finally, unlike the export tax, they raise the cost to Canadian exporters to all markets. This, in turn, benefits U.S. exporters as well.

Our biggest complaint with Canada's administration of the agreement is that it has not been as transparent as we believe it should be. Though the Canadians appear to be respecting the letter of the agreement by providing us necessary data and investigating potential violators, they have been somewhat reluctant to discuss with us their enforcement systems or to provide greater two-way communication.

We strongly believe that increased transparency and cooperation between the two Governments would significantly improve the enforcement and administration of this agreement. We are making some progress in this area, and we continue to work with the Government of Canada on this issue.

In conclusion, Mr. Chairman, I would note that the MOU has been effective in offsetting the subsidies which distort fair trade in lumber between the United States and Canada. Until such subsidies are eliminated, the U.S. Government will continue to enforce vigorously the MOU.

[Ms. Chorlin's statement may be found in the appendix.]

Chairman Wyden. Ms. Chorlins, we thank you, and I appreciate your making mention of those on the timber team, because Mr. Jenning and our staff have felt your whole group has been very helpful in terms of dealing with these issues.

Mr. Spetrini, would you like to add anything?

Mr. Spetrini. No; thank you.

Chairman Wyden. Ms. Chorlins, let me amplify a little bit on what the Canadian trade minister, John Crosby, said yesterday. I noted earlier, in discussing with Congressman Morrison during his comments, that the minister said they wanted to scrap the 15-percent tax on Canadian softwood exports. The story goes on, as was reported yesterday in Canada, to quote Mr. Crosby to say, "Any fair-minded observer, we believe, would agree that there is no longer any requirement or a need for such a memorandum."

So, that is about as blunt as it gets. I think all of you in the trade world, and sometimes us on Capitol Hill, live in this kind of foggy world of limp statements and ambiguity. That isn't limp or ambiguous. It is pretty clear what the trade minister of Canada feels.

Now, I am of the view that the key to keeping a formal proposal from coming from the Canadians to our country for abrogation of the MOU, or significant alteration of it, is for there to be a clear comment and a clear signal on the part of the Bush administration, that the Bush administration is prepared to use the full area of enforcement tools, 301 specifically, and even more specifically, the prospect of a countervailing duty, if that is what it would take.

The Reagan administration, as I have noted, specifically went on record as saying that they would, if it was necessary, be prepared to go to countervailing duties to enforce this agreement. As I say, I think if we want to keep a formal proposal from coming initially, it is important that we show that we are prepared to go the distance on the enforcement issue.

Is the Bush administration, since you are here representing the administration, willing to make a commitment now to the Hill as Ronald Reagan did? If it is necessary to enforce the MOU, will the Bush administration, like the Reagan administration, look to countervailing duties and look on to 301?

I think this is a very, very important question. I guess I have never been accused of beating around the bush and you are getting it right out of the box, but I guess I would like to know the administration's thinking on that.

Ms. CHORLINS. Mr. Chairman, I appreciate your frankness in asking the question. I would begin by citing to you an excerpt from a letter from Secretary Mosbacher, dated January 18 of this year, in which he states, "We are firmly committed to the MOU and will take any action necessary and appropriate to enforce the terms of the agreement."

I don't think we can say it any more bluntly than that, than to suggest to you that we stand firmly behind the MOU and don't see any reason at this point to change the terms of the MOU or to consider its termination.

I would point out, as a technical matter, that the MOU was negotiated in response to, as you know, a preliminary affirmative determination in a countervailing duty investigation by the Department of Commerce in which we determined that Canadian lumber exports to the United States were being unfairly subsidized.

Upon the negotiation of the MOU, the coalition which originally filed the countervailing duty petition did, in fact, withdraw it and the investigation was terminated.

If the industry believes either that the terms of the agreement were not being met, or that there were new subsidies that required investigation, then we would encourage them to provide us with that information, and we would examine it carefully and proceed accordingly.

We would not technically be in a position to impose countervailing duties because there is currently no investigation ongoing, and the law, as you well know, requires a finding pursuant to one of these investigations before countervailing duties could be applied.

Chairman **Wyden**. Well, I appreciate that, and what we are talking about here is a policy.

Ms. **Chorlins**. Clearly.

Chairman **Wyden**. Position, and what I understand you to have told me is that, number one, the Bush administration in no way wishes to change from the Reagan administration's position that they will use any tool necessary, including countervailing duties, including 301, to enforce the agreement.

Ms. **Chorlins**. I would simply reiterate, any tool which would be necessary and appropriate according to our statutory and international obligations.

Chairman **Wyden**. Let us move on. I think you heard several of our witnesses say that pressures have increased on the Canadian Government to mitigate or abrogate the agreement, and the pressures will grow as the recession in the lumber markets continue.

Given that so many are talking about this recession going on for some period of time, do you think that portends or almost ensures that there will be an effort by the Canadians to try to end this agreement?

Ms. **Chorlins**. Mr. Chairman, I have been in this position at the Department now for about 7 months, and one of my first tasks was to testify before a subcommittee in the other body on a variety of United States-Canadian issues. That was about 4 or 5 months ago, and, at that time, there were a number of rumors circulating about an imminent proposal from the Canadian Government about the termination of this agreement.

I mention this to illustrate that these rumors have been circulating for quite sometime without any formal proposal forthcoming. I think there is really not much for us to respond to at this time. Certainly, the pressures will continue on the Canadian Government, but until such time as they come forward with a formal proposal, we believe we have a path well defined for us, and we don't see any reason to deviate from that path.

Chairman **Wyden**. That wasn't the question, though. The question was, as the markets dip downward, if you assume there is a recession, doesn't that create significant pressures on the Canadians to change the agreement?

Ms. **Chorlins**. From their perspective, certainly.

Chairman **Wyden**. Now, you say the export taxes worked. The subsidy that Canadian Provinces gave to their wood products companies prior to the 1986 agreement has, in some cases, been eliminated. Is that essentially our position for allowing the Province of British Columbia to eliminate the export fee altogether for shipments from that Province to the United States?

Ms. **Chorlins**. No; the Province of British Columbia negotiated one of the so-called replacement measures which I discussed earlier.

The MOU basically provides for two ways to cope with the subsidy, one through the imposition of the export tax or alternatively through a replacement measure. The replacement measure amounts to an increase in stumpage rates, either partially or wholly, to offset the export tax, and it was under that aspect of the

MOU that the Province of British Columbia was able to decrease the export tax.

Chairman WYDEN. I want to talk to you about these subsidies and get your assessment about the latest data. If you look at the comparative numbers on the stumpage rates per thousand board feet between two similar regions, coastal British Columbia and the Westside Forest, the Oregon and Washington forest, here is what you get in terms of possible MOU figures.

In 1988, B.C. timber was being sold at $40 while Oregon timber went for $124. In 1989, B.C. timber went for $40 while Oregon went for $174. In 1990, a big jump, B.C. timber went for $44 while Oregon timber went for $198. Finally, in the first quarter of 1991, B.C. timber went up another two bucks to $46, Oregon went up to an average of $254. So, what we have is a situation where we have allowed the export fee to go down to zero, but it sure as heck doesn't look like the subsidy has been much decreased.

What is your response to these figures, and what should be done to address the trend? I think the trend is very significant, and certainly is going to become more and more important in the Northwest.

Ms. CHORLINS. Mr. Chairman, I would like to give you a general answer, and I would like to ask Mr. Spetrini to address the specific figures which you raised.

The MOU was negotiated in response to a preliminary finding of unfair subsidization of Canadian lumber. The rate that we found was 15 percent. Hence, the export tax was set at that level. When the MOU was negotiated, the export tax was adequate to offset the effects of subsidized lumber.

I would say at this point that if you believe, or if members of the industry believe either, that the terms of the agreement are not being met or that there are problems in United States-Canada lumber trade which the MOU does not effectively address, then I would encourage you or them to come forward with the information. We would be happy to talk with you and the industry to review the data very carefully.

Chairman WYDEN. Mr. Spetrini.

Mr. SPETRINI. I don't have anything specific to add, but to the extent that it has been stated, let me echo that the MOU doesn't guarantee price equivalents as much as it guarantees that the 15 percent or its equivalent will be collected.

Chairman WYDEN. I think I am at the point where I would say that you all have gone after this, and we are aware of that. Mr. Spetrini and the folks at Compliance Division have worked hard on this.

But I think there are real questions now that need to be asked about whether this MOU has really accomplished its goal. I think, as you said in your testimony, Ms. Chorlins, the goal of the export fee, and I quote here, "to offset the benefit of the lumber exporters of the subsidized Canadian timber prices." I would ask, it doesn't appear that we have accomplished that at this point; have we, Ms. Chorlins?

Ms. CHORLINS. Well, Mr. Chairman, we do believe that the terms of the MOU do, in fact, address the subsidy that we preliminarily found in 1986. But again, I would like to suggest that if you believe there are issues which are not being effectively addressed by the MOU, we would be more than happy to review any information you might like to provide.

Chairman WYDEN. But there still is a very, very large disparity, and doesn't that reflect a very significant subsidy?

Ms. CHORLINS. I don't think that is necessarily the case.

Chairman WYDEN. Well, enlighten the subcommittee on how it is, because I went through those numbers for a reason, and those numbers were supplied from the Forest Service and the Department of Commerce. That looks like a pretty gaping disparity, and very, very high levels of difference between what is charged here and what is charged in Canada.

If it is something other than subsidies, enlighten us.

Ms. CHORLINS. Mr. Chairman, I am not a technical expert, so I am not able to enlighten you on how those specific disparities may have arisen. I would simply point out that when the MOU was negotiated, as I mentioned before, it was in response to a preliminary affirmative finding of unfairly subsidized Canadian lumber imports.

That preliminary finding was the result of a lengthy and complex analysis pursuant to the countervailing duty statute, in response to a petition filed by the coalition. We undertook that analysis in response to our statutory obligations to review the data, and the 15-percent figure, which we preliminarily came up with, was the result of that lengthy and detailed analysis.

As a result, at that time it was deemed that the export tax provided for by the MOU was sufficient to offset the subsidy. If it were to become clear that there were additional information readily available which indicated that the MOU was not, in fact, addressing the problems, we would welcome the opportunity to review any information supporting these claims. We would certainly undertake an analysis to determine whether or not additional steps would be required.

Chairman WYDEN. You would be interested in looking at this new information to see if modifications were necessary?

Ms. CHORLINS. I think we have been prepared throughout the lifetime of the MOU to discuss with industry any concerns it has about the MOU and its effectiveness, and that readiness has not changed.

Chairman WYDEN. Ms. Chorlins, you indicated that enforcing the agreement has not been easy, and I know that has been the case, having talked with your folks over the years. A kind of constant monitoring and compliance and trying to see, when they were supposed to do A, they actually do A and not B.

What have been some of the principal kinds of problems you have dealt with, and we have heard on the subcommittee about problems involving companies end running the export fee by transshipping their lumber from one Province to another for exporting into the States? We heard a lot about underscaling or nonscaling of logs, which means that the cutters are foregoing payment altogether for their timber.

How serious are these problems, and what is being done to mitigate them under the terms of the MOU?

Ms. **Chorlins**. Clearly, Mr. Chairman, I would be remiss if I were to suggest to you that our enforcement efforts have been picture perfect. There have been some isolated problems reported.

I am told that the majority of these problems have been relatively minor and appear to stem in large part from a misunderstanding of the requirements of the lumber program. We are in direct communication with our counterparts in Canada to address many of these problems.

Where the problems may have been found to be more serious, we are working with our counterparts at Revenue Canada, in particular, to determine whether there has been any circumvention of the export tax.

Essentially, our enforcement efforts focus on three basic activities, one of which is a lengthy and detailed review of the more than 250,000 export notices which we collect every year. These documents provide information on the value and the Province of origin of the shipments.

They provide a direct means of monitoring Canadian compliance. Any discrepancies we find in these notices, we take up immediately with our counterparts in Canada.

In addition, we hold quarterly consultations which provide a good venue to discuss these problems and any other issues which might arise pursuant to our enforcement of the memorandum of understanding.

Finally, we have sent teams periodically to the major lumber ports to physically check the shipments and the accompanying documentation.

So, we are continuing, I think, to improve the effectiveness of our enforcement activities. Clearly, increased two-way communication between ourselves and Canada would be an important enhancement to our enforcement efforts.

Mr. **Wyden**. Let me ask you about some of the rail rate issues which figure into this whole debate.

The subcommittee has had some correspondence with the department a couple of years ago on the hauling charge that Government-owned Canadian railroads were making on timber company shipping products to the United States. In essence, there was concern that the rates were being discounted to the shippers.

Again, there was a subsidy arrangement. The focus of the complaint was B.C. rail, and this was a matter that Mr. Spetrini has lots of involvement, probably lots of headaches about over the years.

Could you bring us up to date on the rail rate issues, Ms. Chorlins?

Particularly, what were your findings? What, if anything, was done to ensure that Canadian shippers weren't getting yet another Government subsidy through the rail rate area?

Ms. **Chorlins**. Mr. Chairman, as you know, this issue was brought up in conjunction with the original investigation and then subsequently in 1988. I know that you, in fact, had extensive communication with the Department on this issue.

As I understand it, we investigated this issue as far as we possibly could, particularly in 1988, in light of your concerns, and were, in fact, unable to obtain what we would call conclusive evidence that the rail rates or the pricing practices were specifically providing a benefit to producers in British Columbia and were, in turn, violating the memorandum of understanding.

We have not received any new information reigniting these concerns. Clearly, if there were additional information, we would welcome it and would look at it very carefully.

Mr. WYDEN. You continue to feel this is an area of potential problem?

Ms. CHORLINS. Well, I don't know that I would say that. This issue, I think, has not really been raised for the last couple of years. Were there new concerns or new allegations, however, we would look at them very carefully.

Mr. WYDEN. Ms. Chorlins, you make a point in your testimony that the true solution to the problem is not the memorandum of understanding or the abrogation of the MOU, but trying to get the Canadian Provinces to move toward a market system, a more open kind of system with sale of public timber through competitive bidding.

I gather that some of the Provinces, the maritimes are already starting to sell timber this way. The number one producer, the one that is most important that has contributed, in my view, to that dramatic discrepancy that I have been talking about, is still sticking to an administratively priced system, British Columbia.

What is your sense of the prospects of getting all the Canadians Provinces, including B.C., to move toward this competitive bidding?

Ms. CHORLINS. We are not aware of any initiatives regarding a shift to a widespread market oriented system in Canada, in particular in British Columbia.

We stand by the viewpoint that until such a system exists, there are likely to continue to be distortions in lumber trade between the United States and Canada. Therefore, the memorandum of understanding continues to be necessary.

Again, if you have received any information that would indicate such a shift, clearly we would take a look at it. I am not aware of any initiatives in this regard.

Mr. WYDEN. Are we having discussions with the Canadians, in effect, trying to push and prod them in this direction?

Again, so much of this has been political will. I mean my sense is they are not going to do this voluntarily.

Ms. CHORLINS. My guess is that is an accurate assumption.

I would like to ask Mr. Spetrini to respond because he has participated in these quarterly consultations.

Mr. SPETRINI. We address it in the context of the memorandum of understanding systematically. Certainly, the Government of Canada and the Provincial Governments have every incentive, in the face of the memorandum of understanding and all the disadvantages of market intervention, to move toward such a system.

I assume they have their own political drags on why that has not occurred.

Mr. WYDEN. Could they have been taken care of as part of the GATT Round, the Uruguay Round?

Ms. CHORLINS. Could the bilateral issue between the United States and Canada on softwood lumber be addressed there? I don't believe that necessarily would be an appropriate venue, Mr. Chairman.

Mr. **Wyden**. I am sorry, I was vague on that.

The administrative pricing system, could that have been taken care of on the GATT talks, the Uruguay Round?

Mr. **Spetrini**. I submit, Congressman, that it has been taken care of, indeed, in previous GATT rounds. The current GATT subsidies code allows the United States to implement its own countervailing duty law the way it has. That law, I think, fully arms us to deal with this administrative pricing practice.

The only reason we have the memorandum of understanding is because the two Governments feel it is acceptable.

I submit we do have tools to use as a weapon to offset such subsidy practices, and we have done so.

Mr. **Wyden**. You want to add to that?

Ms. **Chorlins**. No; I think Mr. Spetrini was very eloquent in his response.

Mr. **Wyden**. One other point. In terms of the criticism of the memorandum of understanding and the agreement by the Canadians, there certainly seems to have been some blessings for the Canadian people in it. It seems more reforestation seems to be taking place.

Timberland is being better managed for the long term. Would the administration agree that whether intended or not, this agreement has led to more environmentally sound practices as well?

Mr. **Spetrini**. I think that the existence of the memorandum of understanding in particular is an alternative. It provides the Canadian Government with every incentive to improve their practices across the board in terms of intervening on the market.

I have seen signs that, in terms of individual Provinces, efforts are being made to get out of the business of managing the lumber industry. Frankly, I think those have been around the margins.

The basic problem still remains. That is why we have to continue to be vigilant in enforcing the memorandum of understanding and support continued pressure in that regard.

Mr. **Wyden**. I want to excuse you both at this time. I think you are, obviously, able to see both from my comments and that of our colleagues that this is an exceptionally important issue to us in the Pacific Northwest. Literally, thousands of jobs in our region are on the line.

I remain skeptical that we have accomplished all we should in this area. As I noted, we have allowed the export fee to go down to zero.

It doesn't seem to me, going through those numbers that were supplied to us by your department, the Forest Service, that the subsidy has been much decreased. We want to work very closely with you.

Your associates have been most cooperative. I appreciate your noting, Ms. Chorlins, that the Secretary is prepared to go the distance and utilize any and all enforcement tools to make sure that this memorandum of understanding stands.

We are going to be looking, as you have suggested, at possible ways to strengthen it as well. This is not an abstract issue for us.

The livelihoods and well-being for thousands of thousands of citizens depend on it. We will excuse you at this time, unless there is anything you want to add further.

We will have plenty to be talking to you about in the days ahead.

Ms. CHORLINS. Mr. Chairman, I would simply note that we welcome your comments. Your oversight, as I mentioned at the outset, is important to us in our enforcement efforts. Any information you could provide to us that would further enlighten us about your concerns on these issues, we would welcome. We look forward to continuing a very positive working relationship with the subcommittee and members of the U.S. industry.

Mr. WYDEN. I bet John Crosby is going to be interested in your comments today, given the fact he doesn't think there is a need for the memorandum of understanding any longer.

We thank you.

We will have lots to pursue.

Mr. Spetrini, we thank you as well for your cooperation.

Mr. SPETRINI. Thank you, Congressman.

Mr. WYDEN. Our next panel, Mr. Kip Howlett, chairman, Coalition for Fair Lumber Imports, and Mr. Gus Kuehne, president of the Northwest Independent Forest Manufacturers.

Mr. Howlett, you are accompanied by Mr. Stein. He is with the law firm of Dewey Ballantine and counsel to the coalition.

Mr. Stein, do you anticipate testifying as well?

Mr. STEIN. No; I do not, Mr. Chairman.

Mr. WYDEN. Let us swear you, Mr. Howlett and Mr. Kuehne.

Mr. Stein, let's swear you as well in case you wish to offer any comments.

Do any of you have any objection to being sworn?

[Witnesses sworn.]

Mr. WYDEN. We thank you for your longstanding interest in these issues and cooperation with our office as well.

Why don't we begin with you, Mr. Howlett?

## TESTIMONY OF C.T. "KIP" HOWLETT, JR., CHAIRMAN, COALITION FOR FAIR LUMBER IMPORTS, ACCOMPANIED BY MICHAEL H. STEIN, COUNSEL

Mr. HOWLETT. Thank you, Mr. Chairman.

As chairman of the Coalition for Fair Lumber Imports, I thank you for the opportunity to appear today to discuss the continuing importance of the United States-Canadian Softwood Memorandum of Understanding, the MOU, for the North American lumber industry.

We have additional written materials and graphs that we will submit for the hearing record.

This hearing takes place against the backdrop of calls to eliminate the MOU—calls that emanate from the highest levels of the Canadian Government. High-ranking Canadian Ministers, including International Trade Minister Crosby, External Affairs Minister Clark, and Forest Minister Oberle, have called for renegotiation or elimination of the MOU.

Today, I would like to remind those Canadians, and the U.S. Congress, that the MOU was a necessary response to Canadian timber subsidies that were devastating the U.S. lumber industry.

The U.S. industry filed a legal proceeding that found that Canada unfairly subsidized its timber. Absent the MOU, the United States would have to offset these continuing Canadian subsidies by reinstating the countervailing duty that had been imposed as a result of the legal proceeding.

For years, subsidized Canadian lumber severely injured the U.S. lumber industry. The U.S. lumber industry is one of the most efficient in the world.

Nonetheless, from 1977 to the mid-1980's, hundreds of U.S. lumber mills closed; tens of thousands of workers lost their jobs; hundreds of mill communities were devastated.

Canadian overproduction was the primary cause. Canadian lumber took an ever-increasing share of the U.S. market, reaching almost one-third in 1985, up from just over 20 percent from 1970 through 1976.

This occurred because Canadian firms were subsidized. While U.S. mills must buy timber competitively, Canadian mills were given Government timber at below-market prices that were a fraction of the cost of similar timber just across the border.

As Bob Williams, a former Minister of Forests for British Columbia, noted: "We weren't charging for trees and [the United States] had a competitive bidding system on their public lands that sometimes had their companies paying 10 times what our companies were paying for the same timber. The Americans saw this as a subsidy—and they were right."

Diverse other Canadian sources, from British Columbia's Prime Minister to an Ontario Royal Commission, concurred that Canadian mills did not pay fair timber prices.

In 1986, facing disaster, despite record demand, and having failed in efforts to negotiation an end to Canadian subsidies, the Coalition for Fair Lumber Imports—representing seven major U.S. lumber industry associations and dozens of companies—filed a countervailing duty case.

In October 1986, the Department of Commerce imposed a preliminary countervailing duty of 15 percent to offset the Canadian subsidies. Rather than allowing the United States to collect the subsidy offset, Canada sought to settle the case by imposing a 15-percent export tax on Canadian lumber.

The U.S. industry agreed to this settlement, dismissing its countervailing duty case, on the basis of commitments for strict enforcement of the MOU.

Recognizing the importance of the MOU to the U.S. industry and the people and communities that depend on it, and recognizing that Canadian subsidies fully justified a countervailing duty, President Reagan made a formal determination that any breach of the MOU would be a violation of section 301 of the Trade Act of 1974.

The President committed that if such a breach occurred, he would "take action, including the imposition of an increase in the tariff on softwood lumber imported from Canada, to offset" any breach. That commitment is still binding today.

Unfortunately, Canada is now seeking to avoid its MOU obligations. The Canadian Government should be held to its bargain.

The Canadian Government cut a deal to avoid the countervailing duties imposed by the United States pursuant to its international legal rights.

The MOU is favorable to Canada in at least two ways. First, the Canadian Governments and not the United States receive the subsidy offset required by the countervailing duty determination. Second, the MOU did not require the adoption of market timber pricing in ~~Canada,~~ Canada which would have resulted in far more dramatic growth in Canadian timber prices. It only required the 15-percent offset or its equivalent, even though evidence submitted by the U.S. industry showed the full subsidy to be much higher than 15 percent.

The conditions that led to the negotiation of the MOU in 1986 still obtain today. The overwhelming majority of Canadian timber still is sold noncompetitively.

Canadian timber sold competitively commands a far higher price.

Comparable timber fees in Canada continue to lag well behind those in the United States. As long as these subsidies continue, the MOU should continue.

Why do some Canadians want to renegotiate the MOU? At base, they would like to slash stumpage rates once again.

Why do these Canadians want to slash stumpage rates? So they can continue with greater force their policy of boosting employment and profits in their lumber industry by providing the industry with timber fee subsidies. The result: Canadian lumber firms would unleash another tide of heavily subsidized imports to the United States.

We, in the U.S. lumber industry, are sympathetic to Canadian workers who lose their jobs when times get tough. We face the same problems brought on by the recession and the resulting drop in demand.

These are as hard a time as we have seen since the 1982 recession. But unfair trading practices cost U.S. workers and the communities that depend on them, their livelihood.

The Canadians have not put forward a compelling justification for eliminating the MOU. Let's look at two of the primary reasons the Canadians have advanced to justify scrapping the MOU.

The MOU infringes their sovereignty. Canada has the right to price its natural resources as it pleases.

But it has no right to sell subsidized lumber in our market. When we exercised our sovereign and international legal right to countervail that subsidy, Canada requested the MOU.

Now, we are just asking to enforce an international trade agreement. It is no more onerous than any other agreement. Arguably, it is far less onerous than a countervailing duty.

The other major reason advanced by some Canadians for eliminating the MOU is that their forest products industry has been devastated by the MOU. That is simply false.

True, some adjustment in the U.S. market share occurred. That was the point of the MOU. U.S. workers now have a fairer chance to compete, based on efficiency and productivity, and they should not be punished for taking full advantage of that chance.

But the effect on the Canadian forest products industry has been anything but severe. In 1989, the United States imported more Canadian lumber than in any year except 1985.

The MOU has become the scapegoat for a host of ills—the recession, the strength of the Canadian dollar, increasing environmental pressures—that are not caused by the MOU. U.S. mills also are hurting as a result of many of these pressures, and many have closed in the last year in the Pacific Northwest and throughout the United States.

Who is calling for the elimination of the MOU? Those who would benefit the most from its elimination—the big integrated Canadian lumber companies.

In 1985, in British Columbia, for example, a British Columbian newspaper noted that the B.C. lumber industry produced over $6 billion—Canadian dollars—worth of lumber while only paying $185 million in stumpage fees. The Provincial Government spent about $335 million in reforestation efforts—about $150 million more than it collected in stumpage fees. A sweet deal.

Many Canadians do not support the big integrated firms in their quest to restore their subsidies. The lumber industry in the Maritime Provinces, for example, was exempted from the MOU because it buys most of its timber competitively, like U.S. lumber companies.

Now, the maritimes fear that elimination of the MOU will result in greater subsidies elsewhere in Canada that will drive their own market share down.

Competitive bidding for timber—a market in timber—really is not such a radical idea. We do it.

It used to be the norm in British Columbia, until the large companies prevailed upon the Province to create the administered tenure system.

Until they do swallow a market system, we must continue to maintain a mechanism to countervail their subsidies. That mechanism is the MOU.

What is needed is heightened enforcement of the MOU's terms. The coalition has documented Canadian attempts to evade the agreement.

The coalition is not asking for retaliatory action against these and other Canadian breaches. Congress should, however, be aware that MOU enforcement in Canada is not perfect.

The MOU is being nibbled apart by ducks. I suppose that we should be happy we are not being stampeded by elephants. But, as the Canadians call for the MOU's elimination, keep this history of evasion attempts in mind.

Strong enforcement of the MOU, not its elimination, is the wiser public policy.

The MOU is that rarest of birds; a trade agreement that accomplished what it set out to do. It partially offset Canadian subsidies that were devastating U.S. companies.

If the MOU ain't broke, don't fix it. Furthermore, beware of events in other—the GATT Subsidies Code and the United States-Canada-Mexico Free Trade Agreement negotiations come in mind—that might provide opportunities to undermine the MOU.

On behalf of the coalition, I urge the Congress and the administration to resist Canadian attempts to eliminate the MOU. Don't let them once again use subsidies to devastate U.S. workers and the communities that depend upon them.

Thank you for the opportunity to testify.

[Mr. Howlett's statement, with attachment, may be found in the appendix.]

Mr. WYDEN. Thank you, Mr. Howlett.

We will have some questions about all of that nibbling, and stampeding, and all those horrible things you are talking about. I appreciate the helpful testimony.

Mr. Kuehne, we welcome you as well, a frequent visitor to this subcommittee over the years. We appreciate the input.

## TESTIMONY OF M.J. "GUS" KUEHNE, PRESIDENT, NORTHWEST INDEPENDENT FOREST MANUFACTURERS

Mr. KUEHNE. Thank you, Mr. Chairman.

I appreciate your calling this hearing. In the interest of time, and to respond to issues that have been raised here already this morning, I would like to depart somewhat from my prepared statement. I hope my written statement will be included in the record.

Mr. WYDEN. Without objection, your prepared statement will be entered in the record in its entirety.

Mr. KUEHNE. I will go to some of the issues that have come up here this morning and try to respond to some of the statements that have been made.

I represent about 50 companies that manufacture lumber plywood and shingles in the Northwest, mainly in the State of Washington. I came to this town 11 years ago; I think the first person, at least in the modern era, to be concerned about Canadian lumber imports.

I remember testifying before Senator Cohen in 1981 on this issue. I think I probably sat in and participated in more hearings on this issue than probably anyone in the country.

For 7 of the last 11 years, at least from 1981 through 1987, I spent about half my time on this issue.

I hope that I don't have to go back to doing that again. I state this because of the great concern that the people I represent have in this issue in seeing that all that work doesn't come unraveled here.

I would like to talk about a couple of major concerns and issues that have been raised. First, I think a lot of attention has been given to the market share situation.

You have expressed that in your opening remarks, and other witnesses have. I would just say that if, in fact, the Canadians still maintained 33 percent of the market instead of approximately 27 percent, that U.S. mills would have lost an additional 2.7 billion feet in the current lumber market in the United States.

That 2.7 billion feet, to give you some reference, is about the same impact as the entire depression in wood consumption is in the United States in 1990. We are talking about a very significant amount, if the Canadians had maintained 33 percent.

In other words, the hurt that we are feeling in the United States today would be about double what it is. I used to say in 1981 that things are so bad, I don't think they can get any worse.

Well, I tell you, things are bad today, but they could get a lot worse if, in fact, this agreement is abrogated and nothing is done about it.

On the timber price issue, I would go to table 3 in my statement, which shows a comparison of the timber prices paid between Forest Service timber in Oregon and Washington on the west side and the east side, compared to coastal British Columbia and compared with the interior of British Columbia.

As has previously been stated, about two thirds of the lumber coming in the United States does come from British Columbia and continues to do so.

First, on the west side, the top half of that table, let me say that we are talking about Canadian fiscal years. I prepared this table in Canadian fiscal years. For example, the current year we are in is the fourth quarter of fiscal year 1991 in their fiscal year bases.

Their fiscal year ends March 30 of this year. All of those numbers have been translated into Canadian fiscal years. The reason I did that was some of the numbers that the Canadians provided were only available in fiscal year bases that they had.

I wanted to compare apples and apples. You should know that the first quarter of Canadian fiscal year 1991 is actually from April 1 through June 30, 1990. That is the latest data we have from British Columbia.

The second thing is that we put everything in U.S. dollars and in dollars per 1,000 board feet scribner scale.

If you look at coastal British Columbia, you can see they were paying about $18 in fiscal year 1986, $18 in the base period which was used for the comparison.

The preliminary duty bases was basically fiscal year 1986. 1986 was the basis for that determination by the Commerce Department.

There was a 15-percent preliminary duty. That was the base period used. So, what really happened is they increased their stumpage prices in coastal B.C. from $18 to $40. The changes since then are changes affected by the differences in the value of the Canadian dollar.

They virtually have not increased stumpage beyond what the MOU required or the agreement that was signed in 1987 required them to do. Whereas, on our side of the border, we still have to compete with each other for timber, and market prices drive the prices up.

I don't intend to claim that all of this price difference is justified or that none of this price difference is justified. There are differences in species and grade. Probably $40 to $60 of that difference is justified.

Obviously, the differences have grown and continue to grow even beyond what differences occurred when we established the duty back in 1985 and looked at this base period.

The same is true, though not true to as great an extent, in interior British Columbia. Even there, the differences are greater than they were before the duty was put in place.

I am a little bit concerned about some of the things that have been brought out here this morning. It seems to me, if Canada gets some sort of a signal that if they abrogate the duty, we will have to go back to going through a countervailing process, then I think they are going to abrogate the agreement.

I think they will unilaterally walk away from it. Commerce won't have much to say about that.

They are just going to say, "We are not going to live up to it."

If we have to go back through a countervailing duty process, we will have to show injury from imports. There is no possibility of making a record of that until that injury occurs.

The ITC will never let us out of the blocks, you see. We will, in fact, be stuck in the blocks for a few years while we are getting murdered in order to show that we are injured. There will be blood before anybody can do anything about it.

So, it is imperative Canada understand what our Government will do if, in fact, they walk away from the MOU, what immediate action they will take.

Will they, in fact, put a duty as provided for under 301 in place when that occurs? Then will they go back and look at a cross-border comparison as to what level that duty should be in the future at some point?

Maybe that would take another 3 to 6 months for them to make the cross-border comparisons. Maybe that rate should be higher than 15 percent.

Certainly, by the numbers here, it would be justified to be higher. Now, the only way the Canadians are going to live up to this agreement is if, in effect, they feel they have got a chance of getting hurt worse if they don't.

This is what this is all about here. I think that we have to send a clear signal.

There must be a clear signal that something will happen. Clear the types of actions that they can face here if, in fact, they walk away from this agreement. We get into a lot of trouble here when there is too much ambiguity as to what might occur.

We can't stand the hurt that will occur if Canadians are able to give their trees away here for some 6 months or a year period before anything happens. We will all be gone. I won't be up here to represent them because there won't be anybody to represent.

Thank you, Mr. Chairman.

Mr. WYDEN. Thank you.

[Mr. Kuehne's statement, with attachment, may be found in the appendix.]

Both of you have been very helpful. We share your view that this is not a time to give an inch. All of a sudden, just as you said in wrapping up, Gus, you are playing catchup ball at a time when you are very vulnerable. This has been very helpful.

I think there is one question I would ask both of you.

Everybody is aware that the Canadians didn't much like this in the beginning. Probably, from the day it was signed, there was a movement to dump it. Is there any question to either of you, that the sentiment in Canada has turned up over the last few months in terms of dumping?

Let's start with you, Kip.

Mr. HOWLETT. I think if we read the same press accounts that you do, the signals seem to be that there is an interest in changing the current situation. I think, frankly, we fully anticipated this.

We knew that the key leverage and the importance of the MOU would occur in a recessionary climate, in a down market. We are in a very serious recession, particularly in the housing industry.

So, it is not anticipated, but it requires greater vigilance, greater enforcement, and certainly not abrogation of the agreement.

Mr. WYDEN. Mr. Kuehne.

Mr. KUEHNE. I would certainly agree with what has been stated. You see, British Columbia, and this is probably in the other Provinces, they have never faced situations where they are closing mills, and laying off shifts, and having to kind of tool down for market reasons. They have always been in an expansion.

This is a new thing to them. What they have always done before is just not charge for the trees.

In fact, recently they have not even charged for the trees when you remove them from the lands. That is what everybody normally does.

They have said now, that you don't have to pay for the trees until the logs are processed into lumber. They will probably go until the lumber is shipped out of the country next.

They will do everything they can to keep that industry running. This tree MOU is getting in the way of that, of their normal practice just to not charge for trees when the markets are poor.

Mr. WYDEN. Mr. Howlett, the industry obviously doesn't agree with Canadian arguments that stumpage rates are up in B.C., so why not junk the MOU.

Could you amplify a bit on the industry's argument about why they don't agree with that Canadian position?

Mr. HOWLETT. There have been efforts with a replacement measure to increase the stumpage. But certainly, the evidence we have in terms of stumpage prices suggests there is a huge difference between similar grades across the border.

I think that the economic evidence speaks for itself. Really, the MOU is the only insurance that we have that the Canadians, and particularly the British Columbians, don't go back to their old ways of underpricing their stumpage to increase their competitiveness into the U.S. market.

Chairman WYDEN. Now, Mr. Howlett, there are some midway measures that might be put forward by the Canadians. For example, Canada could ask for an exemption for B.C., arguing that the fee already is down to zero in the Province.

Do you think that is a possible kind of strategy? If so, what kind of concerns would you all have about that?

Mr. HOWLETT. Yes; I think it is quite possible. I think, given the answer to the previous question regarding the current situation in British Columbia, we have particular concerns about any exemption for B.C. British Columbia certainly is in a good position to cause havoc to the entire U.S. product wood industry if it dramatically reduces its stumpage. An influx, as Gus indicated in his testimony, of another 2, 2½ million board feet into this country would be devastating.

Chairman **Wyden**. Mr. Howlett, you noted that some of the Canadian Provinces, specifically the eastern Maritime Provinces, actually support it. Why is that the case?

Mr. **Howlett**. Well, they competitively bid for timber, as we do, on 95 percent of the timber lands in the United States. They certainly would be disadvantaged if they had to compete in a marketplace that has subsidized lumber gaining a greater share.

Chairman **Wyden**. In effect, the maritimes are disadvantaged relative to the subsidized program in B.C. just as we are?

Mr. **Howlett**. Exactly.

Chairman **Wyden**. Let me ask you a couple of questions at this point, Mr. Kuehne. On this question of whether the MOU needs to be strengthened, what do you think are the major loopholes that ought to be addressed?

I know you touched on some of them in your written testimony. I particularly note this question of the underscaling or nonscaling instances allowing the timber companies to get away without paying.

We have some new material from a Canadian magazine that recently came out. Let me just read their assessment of the cost of this nonscaling issue.

It says, "Over the same period, due to American pressure to increase stumpage revenues accruing to the Government increase from $200 million to $600 million annually, evidence is mounting that the system is now riddled with holes big enough to drive logging trucks through with losses to B.C. between $25 million and $100 million annually."

That is a Canadian magazine's assessment of this nonscaling problem.

Would you like to talk a little bit more about some of the loopholes and this question of nonscaling, or underscaling, and any others that you think are important?

Mr. **Kuehne**. Yes; I think that one that you mentioned is. I think what we need there is a better investigation of those practices and for Commerce to raise those issues in its upcoming discussions with Canada.

I would say, as well, that what we have here is a continuing agreement. There is no timeframe on it. Yet, the increase in stumpage was based on a one-time base-period comparison.

To strengthen the MOU, your basic question, I think the most important thing to strengthen in the MOU as far as western mills are concerned would be to take a periodic, say every 4 or 5 years, look at the stumpage comparison again and adjust the B.C. stumpage based on current cross-border comparison rather than having this one-time thing that only looked at it once.

We need to build, within the system, an update of that so it takes into account what is occurring now and not what occurred just back in 1985 and adjust it one time just for that. In other words, I would like to see a periodic review of the differences in stumpage prices built into the agreement with British Columbia. I think that is the most important thing we could do.

Chairman **Wyden**. Let me ask you one other question, Mr. Kuehne. We would say, hypothetically, that the MOU is kept pretty much in its current form. You have a situation where stumpage rates that are being charged in B.C. today, which is now selling timber products in the United States, are at a zero fee level because the rates have gone up.

Those stumpage rates in B.C. are still only a fraction paid for similar timber in the Northwest. In fact, we are looking at stumpage that is only one-fourth to one-fifth the rate paid by Oregon timber buyers. Again, you are talking a huge advantage, and to the casual observer this certainly would be an occasion that Canadian purchasers are still very heavily subsidized.

What do you think ought to be done in a situation like that?

Mr. KUEHNE. Well, I think we need an updated cross-border comparison type of thing to determine the level that it should be at. As I stated in my testimony, I believe it is fully justified for stumpage prices to be doubled in coastal B.C. and increased 5 percent over their current rates in interior British Columbia to keep up with, in fact, what changes have occurred since this initial cross-border comparison type work that was done in 1985. So, what needs to be done, I think, is increasing B.C. stumpages.

Obviously, what British Columbia is trying to do is not pay any stumpage at all virtually. So, to do that is obviously going to be quite difficult. That is what needs to be done.

Chairman WYDEN. You would see that as a strengthening kind of decision or amendment to the MOU?

Mr. KUEHNE. Yes, Mr. Chairman.

Chairman WYDEN. Let's see. Just one other one for either of you gentlemen. Do you think that now, in light of the development of a possible United States-Mexico free trade agreement and potential North American free trade, there are ramifications for the Northwest, in particular in our country, given possible Canadian moves to end the agreement.

Mr. Howlett.

Mr. HOWLETT. I think that, given our experience in the Canadian Free Trade Agreement, we need to maintain our vigilance with respect to other possible bilateral and multilateral agreements. The MOU is important because of the subsidization of timber in Canada, and it should not be abrogated as a part of those other negotiations.

Mr. KUEHNE. There is a significant Ponderosa pine resource in Mexico. I am not really sure how that is priced. I think that for the segments of the industry that produce that type of product, that we should pay attention to that resource, how that resource is being priced, how it is being sold, and how it is being moved into this country. I have not done any particular investigation other than to know there is a lot of resource there that is undeveloped at this point.

Chairman WYDEN. Gentlemen, you both have been helpful. It has been a pleasure to work with you two and your organization. We may well want to work closely in the days ahead.

Mr. Howlett, do you want to add anything?

Mr. HOWLETT. Yes; a number of comments with regard to the mechanisms of enforcement and all. I would like to publicly acknowledge and compliment Mr. Spetrini and the staff at the Department of Commerce for their vigorous activities and enforcement. We would not be where we are today were it not for their efforts.

I would like to revise my remarks with regard to the powerful congressional subcommittee chairman who may have taken umbrage at my reference to being nibbled at by ducks. Let me assure you they weren't Oregon ducks. Perhaps I should have referred to Canadian geese.

Chairman WYDEN. Thank you.

Next, Thomas R. Waggener, Ph.D., Professor of Forest Economics and International Trade, Center for International Trade in Forest Products, College of Forest Resources, University of Washington and H. Fred Kaiser, Jr., Director, Forest Inventory, Economics, and Recreation Research, U.S. Forest Service, accompanied by David Darr, Branch Chief, Economics, Trade and Market Research.

Gentlemen, thank you. Thank you for your patience. Do any of you have any objections to being sworn as a witness?

Please rise and raise your right hand.

[Witnesses sworn.]

Chairman WYDEN. Given the lateness of the hour, I would like to ask each of you to submit your prepared remarks in their entirety for the record. They will be included in full.

If you could in, say, 5 minutes or so, highlight your principal concerns. I know that it is almost a biological mandate to have all of us just read these statements to each other. But if you could just talk to us here for a few minutes, that would be very helpful. I know you have taken great time with your efforts. We are going to work closely in the days ahead.

Dr. Waggener, we welcome you. I note you have been very helpful to this subcommittee in the past.

## TESTIMONY OF THOMAS R. WAGGENER, PROFESSOR, FOREST ECONOMICS AND INTERNATIONAL TRADE, CENTER FOR INTERNATIONAL TRADE IN FOREST PRODUCTS, [CINTRAFOR], COLLEGE OF FOREST RESOURCES, UNIVERSITY OF WASHINGTON

Dr. WAGGENER. Thank you very much, Mr. Chairman. For the sake of time, I will abbreviate greatly my prepared remarks.

It is a pleasure to appear again before this subcommittee and discuss issues that are important to the forest products industry and trade. For the record, I am Thomas R. Waggener, Professor of Forest Products Economics and International Trade at the College of Forest Resources at the University of Washington.

There, I participate in the Center for International Trade and Forest Products which was established at the University of Washington in 1984 to assist in the analysis of forest products trade worldwide and to provide information to both Government and business which can be helpful to develop better understanding of the trends and developments influencing our domestic forest products sector and to help establish effective public policy.

In abbreviating my comments, and with the Chair's indulgence, I would like to refer to the graphics attached to my prepared testimony, and to just comment briefly on some of the major features that are shown in the graphics.

I will try to focus my attention primarily on the Pacific Northwest. It is clear that the industries in both the U.S. Pacific Northwest and in Western Canada are encountering difficult times. Certainly, to deny the problems would be a mistake. However, I think, as the Canadians search for the causes—and perhaps for political solutions—that there has been a misplaced emphasis on the MOU.

In very brief summary, Mr. Chairman, I think my comments will indicate, rather, that the difficulties that are encountered are due to: First, the dynamics of markets, the effects of which are shared on both sides of the border; second, macroeconomics of Canada since the signing of the MOU, specifically, with respect to interest rates and exchange rates; and third, the perplexing and confusing implementation of the replacement policies—that have been referred to in lieu of duty or tax—in terms of the stumpage pricing adjustments.

Briefly, in reference to the information contained in the graphics of my statement, some of this has already been well stated, and I will not dwell on this. The cyclical nature of the U.S. industry resulted in domestic lumber production exceeding 30 billion board feet at the peak of the market in the 1978–79 period, with a 20-percent decline to less than 24 million feet in 1982 [Figure 1].

The period, 1982 to 1988, was a very strong recovery. The signing of the MOU came in the middle of this rising period. We peaked out at almost 50 billion board feet in consumption in 1988, which was clearly a third above the peak consumption previously reached in the ensuing, foregoing business cycle which turned down in 1978–79.

Canadian production has also benefited from this recent business cycle. During the early phases, production in Canada was down, in 1982, by 25 percent, with a rather remarkable rise to over 26 billion feet in 1978. This was fully a third above their level of production in the previous business cycle [Figure 2].

Production, of course, follows consumption. We know that the domestic U.S. market is the single largest consumption market in the world. Consumption peaked at the previous business cycle at 42.6 billion feet, in 1978, dropped by 25 percent, and then came back to about 48 billion feet in 1987 [Figure 3].

The recovery in the U.S. consumption was shared by both United States and Canadian producers. But, as has been stated by previous witnesses, the share of the market declined for U.S. producers through 1985. Then, at the imposition of the duty and the signing of the memorandum of understanding, the U.S. share has recovered slightly from a low of about 67 percent for U.S. producers—33 percent share for Canada—to 73 percent—26.7 percent for Canada—today, which is the low for Canada since the memorandum of understanding [Figure 4].

Now, rather dynamic changes have been taking place in the United States as well in terms of the source of consumption. Figure 5 of my testimony indicates the Western share has actually declined from 22 percent in 1975 to 16 percent in 1982 and again in 1989.

At the same time, the Canadian share increased and peaked in 1985, before declining to approximately 27 percent. The U.S. South was also a gainer in this process, displacing markets previously held by the U.S. Northwest.

Figure 6 clearly shows these trends in productions of lumber within those three regions—the west coast of the United States, the U.S. southern region, and the Province of British Columbia.

During the rise in the business cycle, the U.S. industry approached a situation of operating at or very close to full capacity, as shown in Figure 8. However, since the boom times of 1987, this has steadily declined to where the industry today, in both the coastal and inland regions, is operating at about 80 percent of capacity.

Figure 9 illustrates the realization from lumber from both the U.S. inland region and the coastal region. Simply, what I would like to indicate here is that, even though consumption and production recovered very strongly as we came out of the 1982 recession, prices have not. They have only increased very modestly in the coastal region, from an average realization of about $204 to $240. This is actually down from early 1989 levels.

The inland region has a similar pattern, and is realizing only approximately $30 more than they did in January 1986.

If we look at comparative shipments to the western region, the backyard for our Northwest forest industry, again we see some rather dramatic changes [Figure 10].

While both the inland and the western U.S. producing regions have shared in increased shipments to the western markets, shipments from Canada have increased about 1.2 billion or by 120 percent since 1982. They have made major inroads into shipping into the region where we would likely assume that our Northwest producers would have a greater comparative advantage.

Why has all of this occurred? What has been the effect on our Canadian friends? I think Figure 11 speaks very clearly to the problem that the Canadian industry has faced. In this chart, Mr. Chairman, I have tried to illustrate for your subcommittee the rapid deterioration of actual Canadian price realizations, expressed in Canadian prices, based on the average comparative prices received by U.S. Northwest producers.

I think it is fairly clear there that once we put those prices into Canadian realization terms, the income received by the Canadian producers— for both the coast and the inland regions--the price realizations are at or are only very, very slightly above 1986 levels assuming that exchange rates had stayed the same—-had stayed at 1986 levels.

The lower two lines on this figure point out the discrepancy that has occurred in mill realizations due to the actual decline in the United States-Canadian exchange rate. This rate declined from approximately 1.41 in January 1986 to the most recent figure of about 1.14 Canadian to the U.S. dollar in November 1990.

Figure 12 and Figure 13, for the coast and inland regions respectively, show what the effect on Canadian mill realization would be if a fully implemented 15-percent duty offset was in place. Now, obviously, that policy has again reduced the income realization for the Canadian producers.

We see, if you look at the most recent figures, the gap due to exchange rate differentials has actually continued to grow and takes a much larger bite out of mill realizations from selling in the U.S.

market than would be the case if exchange rates had remained constant.

By my calculations, the net cost, if you will, to Canadian producers due to the dual problems of the exchange rate differential and a fully implemented 15-percent reduction, either due to a tax tariff and/or cost increase imposed through other means, would have resulted in about a $682 million differential as of 1990.

Of this, about $300 million would have been due to a fully implemented 15-percent tariff, while $382 million would have been the reduction due to the deterioration of the Canadian dollar. That, in itself, has left the Canadian producers with an actual decline in mill realizations over and above any changes in the duty or tariff.

Now, the question has arisen as to the adequacy or the equivalency of the initial 15-percent duty finding. As has been stated by previous witnesses, that was a one-time initial calculation of the subsidy differential. It is very unclear, particularly in the case of British Columbia, with revision of stumpage rate policies, and to some extent the shifting of additional cost to operators through reforestation and other ongoing management, what the actual, current, in-place differential really is.

My analysis assumes a continuing full implementation of 15 percent. I think there is a great deal of confusion, and room for further analysis, as to how that initial 15-percent adjustment has turned out in practice subsequent to 1986.

I would conclude my testimony at that point, Mr. Chairman, and would be pleased to answer any questions that you might have.

[Dr. Waggener's statement may be found in the appendix.]

## TESTIMONY OF H. FRED KAISER, JR., DIRECTOR, FOREST INVENTORY, ECONOMICS, AND RECREATION RESEARCH, U.S. FOREST SERVICE, ACCOMPANIED BY DAVID DARR, BRANCH CHIEF, ECONOMICS, TRADE AND MARKET RESEARCH

Dr. **Kaiser.** I would like to thank you for the opportunity to participate in your review of the 1986 United States-Canada Memorandum of Understanding on Softwood Lumber.

The USDA Forest Service provided technical advice on the forest products market to the U.S. Department of Commerce as this agreement was being negotiated. In my testimony today, I will review trends in these markets since the Memorandum of Understanding was signed.

In 1986, the Canadian MOU on softwood lumber was an important interaction during the period of 1987 through 1990, as shown in our figures 1 and 2. However, as shown in figures 3 through 14, there were many other factors that determined this market share.

These structural shifts include downturn in U.S. housing, increases in U.S. exports, and the decline in timber sales in Oregon and Washington, and, also important, the exchange rate that Dr. Waggener suggested was an additional important factor. Canadian share of U.S. lumber market declined since the signing of the MOU.

U.S. lumber prices, production, employment, and stumpage prices all have increased following the signing of the agreement.

Stumpage prices in British Columbia at least doubled after the implementation of the replacement measure.

Therefore, we feel that the United States and Canada MOU on 12-foot lumber was an important factor in determining both market share in the United States and Canadian lumber sales as well as our prices that we receive from our Nation's forest.

[Dr. Kaiser's statement may be found in the appendix.]

Mr. **Wyden**. Well said.

Is that going to be the conclusion?

Dr. **Kaiser**. Yes; I will go for that.

Mr. **Wyden**. You have moved at record speed to summarize that. I note you have many useful amplifications in your prepared statement, in the housing area, and prices, and the like.

That is very helpful. Mr. Darr

Mr. **Darr**. I have nothing to add to Dr. Kaiser's testimony.

Chairman **Wyden**. All right.

Let's start with you, Dr. Waggener.

The Canadians claim that MOU must be done away with because it is destroying their lumber industry.

In your view, is the MOU being made into a scapegoat for other, more systematic problems?

Dr. **Waggener**. I think, as I stated, that clearly their industry is having difficulty, just as the Northwest industry, as you well know, is facing difficulty, since late 1989; actually, the start of the decline period in the spring of 1988.

I think the difficulty is largely, if not in substance, attributable to both the sickly nature of the market, the expansion of total industry capacity throughout the United States and Canada, which has dampened any recovery in prices commensurate with the upswing we had in consumption, and now, of course, the difficulty of the down market coupled with those relatively low prices.

Second, and clearly in the case of Canada, the erosion of the Canadian dollar has, in effect, stolen a rather substantial share of the mill realizations of selling in U.S. dollars in the U.S. market. The more significant, macroeconomic factors in Canada are, of course, beyond the control of the forest industry.

I think if I was in their position, I would try to find something I thought I could get ahold of to try to rectify the problems.

In effect, the fact that they cannot increase the realization through a more stable monetary and fiscal policy, as expressed in the exchange rates, their clear alternative is to deal with their cost side.

The only way they can increase their spread is to decrease costs if they cannot increase revenue.

Chairman **Wyden**. That is one of the most diplomatic descriptions I have heard of scapegoating in some time. I guess the question I have is, I note the downturn in the cycle, exchange rate and the like.

Do you think, after this passes over, that the Canadians would then reduce their calls for repealing the MOU?

Dr. **Waggener**. If we move past the current recessionary cycle, you mean?

Chairman **Wyden**. Yes.

Dr. WAGGENER. Well, I think it has been very evident. I am reminded, as a long-time student of these issues, that I first did a thesis in 1963 of all things on Canadian lumber imports, and it is very clear that these things become issues in down markets when there is increased competition for declining markets, at a time the producers have high costs.

If we look at the early 1960's, then the late 1960's, we moved into the 1974 era, we see we have had recurring cycles of these kinds of concerns. I think 1986 was the exception, where this came to a head during a rising market and when the drop in the exchange rate had actually increased Canadian share.

But, yes; I think the alleviation of the market difficulties—if suddenly we turned around and increased housing starts in the United States, had lower interest rates, expanding demand and consumption—I think there would be less, certainly much less, pressure if prices recovered proportionately.

I think without price recovery we can expect the pressure to continue.

Chairman WYDEN. What is the role between the Western Canadian producers suffering greatest losses and the Province of British Columbia being one of the only Provinces to raise the stumpage prices, in so doing prompting the removal of the 15-percent duty?

Dr. WAGGENER. I don't have the exact figures in front of me, but I think the import from British Columbia accounts for roughly 75 percent of the volume moving into the U.S. market.

The other major sources are coming from the Provinces of Quebec and Ontario.

I believe Ontario and Quebec accounts for another 12 to 13 percent.

So, in total, between British Columbia and Quebec, that would be around 88 percent.

Both of those regions have adopted some adjustment policies in lieu of the import tax/export tax issue.

Relatively less of the volume is coming from Provinces that haven't made some type of cost adjustment.

The duty itself, I believe, would have a minor bearing. It is how those cost adjustments are indexed or adjusted, and that means, in terms of the relative proportion of product value, that will really tell what happens under the MOU in the future.

Chairman WYDEN. Let me move to you, Dr. Kaiser and Mr. Darr.

The Canadians have criticized the MOU for having a grossly negative effect on their industry, and I am curious whether you think that really overstates things?

It really hasn't been that dramatic, and a big problem for them is essentially the suggestion.

Dr. KAISER. As our testimony shows, we feel the downturn in the housing market has been very significant, particularly because of the type of lumber they produce.

So, it is tough times for our industry in the United States, and it is certainly tough times up in Canada for those producers.

We would look at that as an important factor.

Another one mentioned is the exchange rate, and this has changed some situations between the Canadian producers and the U.S. ones.

If one looks at the chart over the period since 1980, we have really changed positions twice. As the exchange rates adjust, further adjustments will occur.

The MOU, we feel, is a factor in determining the market share, but these other two underlying factors, housing starts in the United States and exchange rates, are probably what the Canadian producers today are really feeling.

Chairman **WYDEN**. Mr. Darr, do you think the effect of the MOU is as dramatic as the Canadians are saying?

Mr. **DARR**. Again, as we pointed out in our testimony, we see the stumpage price doubled after the MOU, after the replacement was put into effect.

In Interior British Columbia, it went up by a factor—I don't recall the exact number—seven or eight.

If I was a member of the British Columbia industry, I would think that was a dramatic effect; yes.

Chairman **WYDEN**. Do either of you, Dr. Kaiser, Mr. Darr, think there are loopholes in the MOU, loopholes that need to be tightened?

Dr. **KAISER**. We are not in the enforcement group, Congressman, and we do work as a consultant on occasion with them, but I am not aware of any loopholes per se that were negotiated.

We worked on the original aspects of it, and it looks like the MOU is being honored, as far as we understand the situation.

Chairman **WYDEN**. But the discrepancy is still so large. How can we say the MOU is working?

You guys, I think, were here when I went through those numbers, and I think your department supplies us with those numbers.

Dr. **KAISER**. You have quoted our own data.

Chairman **WYDEN**. How can we say this is working so well?

Dr. **KAISER**. We can't say it was working well. We said it was working, but the situation I think here is also that one has to look at what is happening in the Pacific Northwest because of the adjustments in supply recently from the spotted owl and other issues that you know so well.

As we pointed out in our testimony, the way supplies are coming into the United States is certainly having a big impact on some of the pricing there that is not a part of the Canadian-United States MOU.

Chairman **WYDEN**. Mr. Darr.

Mr. **DARR**. I would just add that in the U.S. timber industry, we have a competitive market, and prices have been bid up in the last year or two.

There is not such a competitive bidding system in British Columbia. So, we are seeing their numbers stay relatively flat, and we are seeing ours go up.

Chairman **WYDEN**. Dr. Kaiser, you note in your testimony that the increased demand for Northwest lumber in, for example, Japan has caused increases in the price of domestic lumber, and, as a result, the Canadian lumber is competitive.

Has this happened in spite of the MOU or what is at issue here?

Dr. **KAISER**. The United States is shipping offshore.

Your areas, I believe, are affected, so you are quite familiar with the situation.

It has made a situation that is very competitive in the Northwest more competitive, and I think it has contributed to higher prices in the United States.

Chairman **WYDEN**. Let me pose this to the Forest Service. The Coalition for Fair Lumber Imports stated that the higher stumpage prices paid by U.S. firms are conducive to good timber management.

U.S. forest industry experts note that U.S. producers tend to use more of the logs because they have to pay more for it.

If the Canadian industry adopted a market system for stumpage, does the Forest Service believe that their timber management would improve?

Dr. **KAISER**. That is a—you are talking about somebody else's sovereignty. I get a little reluctant to criticize.

Chairman **WYDEN**. You all are the Forest industry experts, and these seem to be important arguments made by the industry.

Dr. **KAISER**. I was the one who accused the Canadians of not being environmentally sound in the MOU negotiations, so I am at a tender moment here.

The record does look like the Canadian forest industry situation in British Columbia is improving.

We know that in Quebec they are showing positive improvements in silviculture management areas. So, the curve is showing an increase in the forest management area.

Chairman **WYDEN**. But it is improving as stumpage costs go up.

Dr. **KAISER**. They are using the money to refinance their activities.

Chairman **WYDEN**. Gentlemen, you all have been cooperative, and given the fact that we have posed questions using your own data to reflect our concern about these prices and the discrepancies, I know these are difficult questions to answer at a hearing, and the like. We appreciate the cooperation, and we will want to work with you in the days ahead as we look both to keeping the MOU in place and possibly strengthening it to address some of those loopholes.

Thank you.

Unless there is anything further, the subcommittee is adjourned.

[Whereupon, at 12:15 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

# APPENDIX

News From
Congressman
RON WYDEN

THIRD DISTRICT
OREGON

2452 Rayburn House Office Building • Washington • DC • 20515 • (202) 225-4811

## OPENING STATEMENT

## DUMPING OF SUBSIDIZED CANADIAN LUMBER IN THE U.S.: HAS THE 1986 M.O.U. ON SOFTWOOD LUMBER LEVELLED THE TRADE PLAYING FIELD?

BY REP. RON WYDEN
BEFORE THE
SMALL BUSINESS SUBCOMMITTEE ON REGULATION,
BUSINESS OPPORTUNITIES & ENERGY

February 22, 1991

Today the Subcommittee on Regulation and Business Opportunities measures the effectiveness -- and the future -- of the U.S-Canada Memorandum of Understanding on Softwood Lumber.

This agreement, signed in 1986, has stood for more than four years, now, as the U.S. lumber industry's principal protection against the dumping of highly government subsidized Canadian wood products in the U.S. domestic market.

Should anyone think this agreement to be just so much trade bureaucracy wheel-spinning, consider some numbers from the decade just prior to the MOU's signing.

> -- Roughly from the mid-1970s to the mid-1980s, U.S. timber companies shut down more than 600 domestic timber mills and eliminated more than 30,000 timber jobs. Many of those closures occurred in the Pacific Northwest.
>
> -- In that same period, the Canadians' share of the U.S. market almost doubled, finally reaching approximately one-third of all lumber products sold in this country.

The U.S. wood products industry was hemorraghing, and Canadian timber companies -- aided by the stewards of Canadian public forests -- held the straight razor.

This was not simply the result of economically inevitable belt-tightening, modernization and labor-saving efficiencies. Consider the price Canadian wood products companies were paying for their timber. Credible data suggests that government owned timber in the Canadian provinces sold for as little as one-tenth the price of similar standing timber in the United States.

According to public record data gathered by subcommittee staff, the cost advantage remains impressive. Last year, for example, public timber purchasers in western Oregon paid an average of $198 per one thousand board feet. Purchasers of very similar timber in western British Columbia, however, paid only $44 per one thousand board feet.

The Chair points out that we are making darn close comparisons in terms of trees and terrain.

Saying that Canadian politicians give away public timber to powerful Canadian timber companies may be too strong. Clearly the Canadian timber companies get a sweet deal at the expense of the Canadian public, and the pain of U.S. timber companies and their employees.

The Administration needs to answer a key question, today: given the wide disparity -- a gap which is getting bigger, not smaller -- between Pacific Northwest and British Columbian timber values, has the MOU been enough to resolve the basic problem?

In the Chair's view, more needs to be done.

The 1986 MOU was our effort to reach a more level playing field. The Canadians -- faced with the threat of a countervailing duty on a number of Canadian imports to the United States -- agreed to allow provincial governments to collect up to a 15 percent export "fee" on all finished wood products bound for U.S. markets. That fee could be adjusted downward as Canadian stumpage -- the rate buyers pay for standing timber -- went up towards a true market level.

In Canada this has been no easy task. In the U.S. true market value is established through competitive bidding on public and private timber. Across the border, however, prices are set "administratively," with preferences traditionally allowed to certain big timber operators.

The result: high prices for timber in the United States under a free market system, and government subsidized prices in Canada to support certain timber companies.

If such a system had no impact on the United States, I wouldn't quarrel with it. But the fact is that Canadians over the last thirty years -- beginning at a time when their U.S. market share was in the low single digits -- have used this system to bludgeon our timber products industry.

Representatives from our own timber industry will testify, today, that the MOU has at least sealed some holes in the dike.

U.S. suppliers under heavy pressure from subsidized Canadian imports now see Canadian products priced at levels closer to true market value. And while this has decreased the profitability of some of Canada's largest timber products companies, there's no indication that Canadian suppliers or their workers are being put out of business by this agreement.

Ironically, one of the big winners in this agreement turned out to be Canadian provincial governments, some of whom have collected hundreds of millions of dollars in fee revenues.

For these provinces, this has truly been a "pay-me-now-or-pay-me-later" situation.

But the Canadian timber companies, who have always loathed the agreement and the price restrictions it places on U.S. marketing programs, have turned up the heat on both provincial and federal officials.

They want the agreement dumped and they have found powerful and sympathetic listeners in both the provincial capitals and in Ottawa. Members of Prime Minister Mulroney's cabinet have argued both on the floor of the Parliament and in the Canadian press that the MOU must go. Representatives of the Canadian industry have contacted my staff, suggesting that the official abrogation of the agreement could come at any time.

So while an oversight hearing on the performance of this agreement after four years is appropriate in any case, the timeliness of this session is particularly significant.

The Chair believes that there is a significant prospect that the Canadian government will shortly demand either significant changes to, or the elimination of the agreement. There is a similar prospect that if the U.S. government does not agree to these demands, the Canadians will unilaterally abrogate the MOU.

The question then will be, what will be the U.S. response.

Former President Reagan said four years ago that he would use Section 301 of the trade law to enforce this agreement. Levy the fee, he said, or face the countervailing duty.

The Bush Administration has not gone this far. Will the Bush Administration live up to the promise made by the Reagan Administration.

And what of the Canadian political climate, today? Is the repeal of the MOU inevitable?

Today we'll hear from economists, foresters and timber industry leaders on the past, present and future of this agreement. And we'll also take testimony from representatives of the Commerce Department's International Trade Administration, the chief enforcers of the MOU.

The Chair points out for the record that the subcommittee invited testimony from Canadian witnesses. Those invitations were sent to Mike Apsey of the Council of Forest Industries of British Columbia, Tom Buell of the Canadian Forest Industries Council and Claude Richmond, minister of forests for the Province of British Columbia. These individuals were not picked at random. They represent the most vocal critics of the MOU. Their views would have been of interest and value. Unfortunately, all three turned down our invitation.

Our first witnesses today will be Ms. Marjorie Chorlins and Mr. Joseph Spetrini of the International Trade Administration.

# OPENING STATEMENT OF CONGRESSMAN MIKE KOPETSKI

**Before the**
**Subcommittee on Regulation, Business Opportunities, and Energy**
**Committee on Small Business**
**Hearing on**
**U.S.-Canada Memorandum of Understanding on Softwood Lumber**
**2123 Rayburn Building**
**10:00 a.m. – February 22, 1991**

Mr. Chairman, I want to thank you for inviting me to participate in this hearing this morning. Although I am not a member of this Committee, I am, like you, deeply concerned about the health of the timber and lumber-processing industries in the Pacific Northwest. With the current slump in domestic forest products markets, we must concentrate our efforts to help these industries so vital to our economic well being in any possible way.

Mr. Chairman, it is for this reason I can not think of a more important topic for a hearing than the issue before us today: the U.S.-Canada Memorandum of Understanding on Softwood Lumber. This MOU was negotiated in good faith in 1986 between the United States and Canada after decades of heavily subsidized Canadian lumber flooded American markets, causing U.S. lumber mills closures and sector-wide unemployment. The agreement was designed to partially off-set stumpage rates, the price Canadian manufacturers paid for standing, government-owned timber. This timber was, and in some cases continues to be, priced dramatically below "market" rates paid by U.S. timber companies buying trees through competitive bidding.

The MOU, among other things, requires the Canadian provincial governments to assess an export tax of up to 15% on finished forest products to the United States. Now after five years of enforcement, the Canadian timber companies are starting to make head way on having the export tax dropped. Canadian provincial and federal officials, including senior members of the Mulroney cabinet, have stated that they plan to abrogate the agreement in the near future. With our domestic timber producers already devastated by soft markets and low housing starts, the implications of the Canadians backing out of the MOU could be disastrous for the Pacific Northwest.

Mr. Chairman, I understand that this Committee has received reports that the Bush Administration may let Canadian government unilaterally break this agreement without imposing trade sanctions due to the Canadian support of Operation Desert Storm. While the Administration appreciates Canada's strong showing in the Gulf, it should not impact trade agreements. The Administration must not let our allies take advantage of the need to keep a strong coalition together in support for Operation Desert Storm interfere with our need to keep American mills operating and workers employed.

Mr. Chairman, there are many other important trade issues before us this session -- GATT negoiations, Most Favored Nation status for China , and the U.S.-Mexico Free Trade Agreement of which the U.S. and Canada are partners. I hope this administration will not trade the economic well being of America's small businesses for Persian Gulf support.

Mr. Chairman, I want to commend you for holding this hearing. I look forward to working with you and the entire Northwest delegation in helping the forest-products industries weather the current market problems.

## Statement by The Honorable Jolene Unsoeld (D-Wash.)

### Before the Small Business Subcommittee on Regulation, Business Opportunities and Energy

**February 22, 1991**

Thank you, Mr. Chairman, for holding a hearing on this subject of such great import to the Northwest. Briefly, I want to emphasize that it is imperative we remain united against efforts to eliminate the Memorandum of Understanding. Just as our neighbors to the north, we face a painful recession. Just as neighbors to the north, our timber communities are suffering. But unlike our neighbors to the north, our lumber producers must compete aggressively at the bidding table if they hope to secure that ever-scarcer commodity, timber.

In too many instances the United States has allowed itself to be pushed around when it comes to establishing trade relations. Our difficulty penetrating Japanese lumber markets is a perfect example. Yet, with the Memorandum of Understanding, we have actually forged a workable, relatively fair solution to a previously unfair situation in which a government was virtually giving its resources away. There is no way our companies, even though they are the most efficient in the world, can compete against corporations whose raw materials are heavily subsidized by their government.

Mr. Chairman, if any modifications to the Memorandum of Understanding are made, I ask that they be made to improve implementation and enforcement of the agreement, not to weaken it. We should remember that the Memorandum of Understanding has never fully "leveled the playing field" -- a tremendous subsidy still exists. In 1990, British Columbian producers were paying an average stumpage price of only $48 per thousand board feet, while my constituents in Western Washington paid $225 per thousand board feet. Clearly, Canadian subsidies are not the only, or even primary, factor in this disparity, but even on the eastside forests of Washington (which have not been as hard hit by spotted owl restrictions) our bidders paid $92 per thousand board feet, while purchasers just across the border paid only $38 per thousand board feet.

The Memorandum of Understanding is working for American companies. While Canadian lumber producers still control 26.7 percent of the US market, they had 33 percent of our market in 1985, just before the Memorandum of Understanding went into place. US exports to Canada have increased by 60 percent from 1986 to 1990.

Mr. Chairman, these are not the times to be renegotiating this historic agreement. Our communities are hurting from a reduced timber supply and a national recession. We can't ask them to make more sacrifices. Let's send a message to the Administration to stay the course, hold firm to this agreement, and not let our struggling communities down.

Thank you, Mr. Chairman.

Statement of
MARJORIE A. CHORLINS
DEPUTY ASSISTANT SECRETARY
FOR IMPORT ADMINISTRATION
U.S. DEPARTMENT OF COMMERCE
before the
COMMITTEE ON SMALL BUSINESS
Subcommittee on Regulation, Business Opportunities and Energy
UNITED STATES HOUSE OF REPRESENTATIVES
February 22, 1991

Mr. Chairman:

Thank you for the opportunity to testify before the Subcommittee on Regulation, Business Opportunities and Energy regarding the U.S.-Canada Memorandum of Understanding on Softwood Lumber (MOU). I am pleased that you are interested in this agreement, one which we strongly support. The Department of Commerce has been strict in its enforcement and interpretation of the agreement, and as a result, except for a few problems on which we are working, the Government of Canada is complying with the agreement.

On May 19, 1986, the Coalition for Fair Lumber Imports, on behalf of the U.S. lumber industry, petitioned the Department of Commerce to conduct a countervailing duty investigation, alleging that the Canadian lumber industry was receiving subsidies injurious to the U.S. industry. The Department's investigation preliminarily determined such subsidies existed.

The MOU, which was signed in December 1986, was implemented in lieu of proceeding with the countervailing duty investigation. Under the agreement, a fifteen percent export tax was to be collected by the Government of Canada on certain softwood lumber products exported to the United States. The export tax was designed to offset the benefit to lumber exporters from subsidized Canadian timber prices.

Since 1986, the agreement has been amended to eliminate the export tax on lumber shipments from British Columbia and to reduce the tax on Quebec shipments following forest policy changes by these provinces that increased the cost to the Canadian industry of cutting timber.

## The Economic Effects of the MOU

It is difficult to isolate the effect of the MOU on the price of Canadian lumber in the U.S. market because of the many supply and demand factors that affect price. However, I would like to point out that in the first quarter of 1987, the period immediately following the implementation of the fifteen percent export tax, the price of Canadian lumber in the United States increased 8.7 percent. Prices remained approximately constant through the third quarter of 1990.

Import penetration of Canadian lumber has decreased from a high of 33 percent of U.S. consumption in 1985 to 27 percent today. Most analysts agree that this drop in import penetration is due to both the implementation of the MOU and the strengthening of the Canadian dollar. Since U.S. and Canadian softwood lumber manufacturers are essentially the sole suppliers to the U.S. softwood lumber market, any fall in the Canadian import penetration rate results in an increase in market share for U.S. manufacturers. It is difficult to assess the effect of this fall in import penetration on the strength of the domestic lumber industry, but we believe it has been beneficial.

The impact of the MOU, however, is more far reaching than just in terms of its effect on price. The aim of the MOU was to offset subsidies and the resulting artificial cost advantage provided to the Canadian industry. The MOU has achieved this goal.

## The Mitigating Effect of the Lumber Export Tax on Canadian Stumpage Subsidization

At the time of the signing of the MOU, the export tax was adequate to offset the effect of the subsidized Canadian lumber.

Since then, we have monitored forest policies in Canada to ensure that no further subsidies have been implemented and that the Governments of Canada or any of the Provinces have not instituted any measure that would offset the effect of the MOU. At this time, no further action is necessary.

I would like to stress, however, that we would like to see Canada adopt an open and purely market oriented system. If such a system is put in place, we would welcome any discussion regarding changes to the MOU.

U.S. Government's Commitment to the MOU

Absent a permanent market-oriented system, the U.S. Government remains firmly committed to the MOU and stands ready to take any action necessary and appropriate to enforce the terms of the agreement.

Events in Canada suggest the Government of Canada may be under increasing pressure to renegotiate, or eliminate, the MOU. Some mill closures, a stronger Canadian dollar, and recessionary forces have made the agreement a target. Pressures on the Canadian government are sure to increase if the current economic downturn continues for some time into the future. The Canadian lumber industry and some Canadian government officials have stated publicly that economic conditions warrant, at a minimum, some change to the agreement, if not its termination. However, the Government of Canada has not formally proposed any specific changes to the agreement.

Although Canada's larger economic problems have affected the lumber industry, they have not affected subsidies which the MOU offsets. Many of the underlying problems addressed by the MOU could be eliminated if Canada were to change from administratively determined timber prices to prices set by free market competition. We have not seen any evidence of such structural changes in Canada that might eliminate the need for the MOU. Therefore, we cannot contemplate the termination of the MOU.

## U.S. Government Actions to Ensure Compliance with MOU

As long as the MOU is in place, the United States Government will continue to enforce it vigorously. Our monitoring and enforcement process centers on three main areas:

First, we regularly hold consultations with the Government of Canada to review and discuss the administration and enforcement of the agreement. Such consultations provide a forum to us to discuss any inconsistencies we find in the export tax collection figures and share information on potential violators. We use feedback from these meetings to tighten our monitoring activities.

Second, we maintain an extensive data monitoring system centered around the export notices required with each importation of covered lumber. We use data from these export notices and other Canadian and U.S. trade data to help confirm the tax collection figures. The export notice data also helps us identify potential violators of the MOU.

The third leg of our enforcement process involves physical review of lumber shipments and their documentation at the time of entry. The Department of Commerce, in conjunction with the United States Customs Service, has sent teams to several major lumber importing ports on the northern border to physically check lumber shipments and examine documentation required under the softwood lumber program. These operations allow us to verify that the lumber is being properly described and that the province of origin designation on the required documentation is correct. These operations have generally shown that most Canadian softwood lumber producers are complying fully with the MOU reporting requirements. We have discovered some individual problems, and we continue to work with the Government of Canada to resolve these problems and improve this aspect of compliance with the agreement.

## Canadian Compliance with the Agreement

To date, we believe Canada has been complying with the agreement, although this has required a high degree of vigilance on the part of the Department of Commerce. We believe that the U.S. industry generally supports our view regarding Canadian compliance with the MOU.

The Government of Canada established the fifteen percent export tax in 1987 and has collected over C$582 million in taxes on softwood lumber exports. Generally, however, we believe a much more effective means of meeting the objectives of the MOU are through so-called replacement measures, whereby provinces can offset part or all of the export tax by raising the amount they charge their industry to harvest timber. To date, replacement measures have been adopted in British Columbia, which accounts for approximately 75 percent of all lumber imports from Canada, and Quebec, which accounts for about 12 percent. While Quebec's original replacement measure expired last October, a new four-year measure was negotiated last fall.

These measures require less monitoring and enforcement than the collection of an export tax, as they apply equally to all lumber production rather than just that portion that is exported to the United States. This greatly reduces the opportunity for circumvention. In addition, replacement measures represent structural changes: they help to set the stage for potential elimination of the subsidies which generated the need for the MOU in the first place. In addition, unlike the export tax, replacement measures raise the cost to Canadian exporters to all markets, benefitting U.S. exporters as well.

Our biggest complaint with Canada's administration of the agreement is that it has not been as transparent in some respects as we believe it should be. The United States Government interprets the MOU as providing for open communication between the Governments of the United States and

Canada regarding enforcement and administration of the agreement. The Government of Canada views the collection of the export tax as a Canadian matter and is reluctant to share taxpayer-specific information with us in problem cases we have identified. While the Canadians appear to be respecting the letter of the agreement, by providing us necessary data and investigating potential violators, they have been reluctant to discuss with us their enforcement systems or to provide greater two-way communication. We strongly believe that increased transparency and cooperation between our two governments would significantly improve the enforcement and administration of the MOU. We are making some progress and continue to work with the Government of Canada on this issue.

## Conclusion

The MOU has been effective in offsetting the subsidies which distorted fair trade in lumber between the United States and Canada. Until such subsidies are eliminated, the United States government will continue to enforce vigorously the MOU.

That concludes my formal testimony, Mr. Chairman. If you or the Subcommittee members have any questions, I will be happy to answer them.

**Testimony of C.T. "Kip" Howlett, Jr.**
**Chairman, Coalition for Fair Lumber Imports**

**Concerning the U.S./Canada Softwood Lumber**
**Memorandum of Understanding**

**Before the**
**Subcommittee on Regulation, Business Opportunities**
**and Energy**
**of the House Committee on Small Business**

February 22, 1991

Mr. Chairman and members of the Subcommittee, my name is Kip Howlett. I am Chairman of the Coalition for Fair Lumber Imports. Let me begin by thanking you for the opportunity to appear today to discuss the continuing importance of the U.S./Canada Softwood Lumber Memorandum of Understanding ("the MOU") for the North American lumber industry.

This hearing takes place against the backdrop of calls to eliminate the MOU -- calls that emanate from the highest levels of the Canadian Government. High-ranking Canadian Ministers, including International Trade Minister Crosbie, External Affairs Minister Clark, and Forest Minister Oberle, have called for "renegotiation" or elimination of the MOU.

Today I would like to remind those Canadians, and the U.S. Congress, that the MOU was a necessary response to Canadian timber subsidies that were devastating the U.S. lumber industry. The U.S. industry filed a legal proceeding that found that Canada unfairly subsidized its timber. Absent the MOU, the United States would have to offset these continuing Canadian subsidies by reinstating the countervailing duty that had been imposed as a result of that legal proceeding.

For years, subsidized Canadian lumber severely injured the U.S. lumber industry. The U.S. lumber industry is one of the most efficient in the world. Nonetheless, from 1977 to the mid-1980s, hundreds of U.S. lumber mills closed; tens of thousands of workers lost their jobs; hundreds of mill communities were devastated.

Canadian overproduction was the primary cause. Canadian lumber took an ever-increasing share of the U.S. market, reaching almost one-third in 1985 (up from just over 20% from 1970 through 1976).

This occurred because Canadian firms were subsidized. While U.S. mills must buy timber competitively, Canadian mills were given government timber at below-market prices that were a fraction of the cost of similar timber just across the border.

As Bob Williams, a former Minister of Forests for British Columbia, noted:

> We weren't charging for trees and [the United States] had a competitive bidding system on their public lands that sometimes had their companies paying ten times what our companies were paying for the same timber. The Americans saw this as a subsidy -- and they were right.

Diverse other Canadian sources, from British Columbia's Prime Minister to an Ontario Royal Commission, concurred that Canadian mills did not pay fair timber prices.

In 1986, facing disaster despite record demand and having failed in efforts to negotiate an end to Canadian subsidies, the Coalition for Fair Lumber Imports -- representing seven major U.S. lumber industry associations and dozens of companies -- filed a countervailing duty case.

In October of 1986, the Department of Commerce imposed a preliminary countervailing duty of 15% to offset the Canadian subsidies. Rather than allowing the United States to collect the subsidy offset, Canada sought to settle the case by imposing a 15% export tax on Canadian lumber. The U.S. industry agreed to this settlement, dismissing its countervailing duty case, on the basis of commitments for strict enforcement of the MOU.

Recognizing the importance of the MOU to the U.S. industry and the people and communities that depend on it, and recognizing that Canadian subsidies fully justified a countervailing duty, President Reagan made a formal determination that any breach of the MOU would be a violation of Section 301 of the Trade Act of 1974. The President committed that if such a breach occurred, he would "take action (including the imposition of an increase in the tariff on softwood lumber imported from Canada) to offset" any breach. That commitment is still binding today.

Unfortunately, Canada is now seeking to avoid its MOU obligations. It is against this background of Canadian subsidization and resulting injury to U.S. industry that Canadian Government calls for abrogation of the MOU should be evaluated.

The Canadian Government should be held to its bargain. The Canadian Government cut a deal to avoid the countervailing duties imposed by the United States pursuant to its international legal rights.

The MOU is favorable to Canada in at least two ways. First, the Canadian governments and not the United States receive the subsidy offset required by the countervailing duty determination. Second, the MOU did not require the adoption of market timber pricing in Canada -- which would have resulted in far more dramatic growth in Canadian timber prices. It only required the 15% offset or its equivalent, even though evidence submitted by the U.S. industry showed the full subsidy to be much higher than 15%.

The conditions that led to the negotiation of the MOU in 1986 still obtain today. The overwhelming majority of Canadian timber still is sold non-competitively. Canadian timber sold competitively commands a far higher price than timber harvested by the big Canadian forest companies under long-term, administered contracts. These subsidies to the big companies are intended to encourage employment and production where the market would not otherwise permit it.

Comparable timber fees in Canada continue to lag well behind those in the United States. As long as these subsidies continue, the MOU should continue.

Why do some Canadians want to renegotiate the MOU? At base, they would like to slash stumpage rates once again.

Why do these Canadians want to slash stumpage rates? So they can continue with greater force their policy of boosting employment and profits in their lumber industry by providing the industry with timber fee subsidies. The result: Canadian lumber firms would unleash another tide of heavily subsidized imports to the United States. Like a junkie in search of his fix, the Canadian lumber industry has become addicted to subsidized timber.

We in the U.S. lumber industry are sympathetic to Canadian workers who lose their jobs when times get tough. We face the same problems brought on by the recession and the resulting drop in demand. But we are not enamoured with Canadian policies that subsidize their lumber industry unfairly to keep Canadian mills running at our expense. These unfair trading practices cost U.S. workers, and the communities that depend on them, their livelihood.

The Canadians have not put forward a compelling justification for eliminating the MOU. Let's look at two of the primary reasons the Canadians have advanced to justify scrapping the MOU.

Perhaps the most visceral, and intellectually bankrupt, Canadian response is that the MOU infringes their sovereignty. Behind this gut feeling is the image of the United States bullying its diminutive Canadian neighbor into an unfair agreement.

Look again. Canada has the right to price its natural resources as it pleases. But it has no right to sell subsidized lumber in our market. When we exercised our sovereign and international legal right to countervail that subsidy, Canada requested the MOU.

Now, we are just asking to enforce an international trade agreement. To the extent that it restricts Canadian freedom of action, it is no less onerous than any other agreement. Arguably, it is far less onerous than a countervailing duty.

The other major reason advanced by some Canadians for eliminating the MOU is that their forest products industry has been devastated by the MOU. That is simply false.

True, some adjustment in U.S. market share occurred -- that was the point of the MOU. Below-market stumpage rates provided a subsidy. The MOU partially offset that subsidy. The MOU enabled U.S. lumber companies to regain market share, production and employment that had been unfairly lost to that subsidy. Canadian market share in the United States has dropped from its peak immediately before the MOU to its lowest percentage since 1979. Employment in U.S. sawmills and planing mills alone increased by almost 15,000 workers between 1985 and 1990. U.S. workers now have a fairer chance to compete based on efficiency and productivity -- and they should not be punished for taking full advantage of that chance.

But the effect on the Canadian forest products industry has been anything but severe. In 1989, the United States imported more Canadian lumber than in any year except 1985. The large integrated Canadian forest products companies that are the prime beneficiaries of stumpage subsidies have not been hurting.

British Columbia's forest products industry, for example, enjoyed record earnings and profits in 1987 and 1988 -- after the adoption of the MOU.

The MOU has become the scapegoat for a host of ills -- the recession, the strength of the Canadian dollar, increasing environmental pressures -- that are not caused by the MOU. U.S. mills also are hurting as a result of many of these pressures, and many have closed in the last year in the Pacific Northwest. Thus, the effect of this host of ills on Canadian companies (and the readjustment in market shares that followed the partial offset of Canadian subsidies) is no reason to eliminate the MOU.

Who is calling for the elimination of the MOU? Those who would benefit the most from its elimination -- the big integrated Canadian lumber companies. In 1985 in British Columbia, for example, a British Columbian newspaper noted that the B.C. lumber industry produced over $6 billion (Canadian dollars) worth of lumber while only paying $185 million in stumpage fees. The provincial government spent about $335 million in reforestation efforts -- about $150 million more than it collected in stumpage fees. Is it any wonder the Council of Forest Industries, an association of the largest British Columbian companies, savagely attacks the MOU?

Many Canadians do not support the big integrated firms in their quest to restore their subsidies -- particularly those small sections of the lumber industry that must buy their timber competitively. The lumber industry in the Maritime Provinces, for example, was exempted from the MOU because it buys most of its timber competitively, like U.S. lumber companies. Now the Maritimes fear that elimination of the MOU will result in greater subsidies elsewhere in Canada that will drive their own market share down.

The smaller loggers -- who must buy timber competitively because they do not benefit from the long-term, below-market leases enjoyed by the integrated firms -- are also not pleased with the cozy stumpage giveaways to the large firms. In fact, buying timber competitively, small B.C. loggers must pay far more for their timber. Small logging companies in British Columbia, for example, harvest 1/6 of the timber but pay 1/3 of the fees. While there are some differences in the obligations incumbent upon companies engaged in competitive and non-competitive timber sales, these differences do not make up for the disparity in stumpage actually paid.

Competitive bidding for timber -- a market in timber -- really is not such a radical idea. We do it. It used to be the norm in British Columbia, until the large companies prevailed upon the province to create the administered tenure system.

In the absence of a market system, the opportunity for powerful interest groups to cut cushy deals for themselves is always present. So is the opportunity for those interest groups to make creative arguments about what the "real" price of timber should be, and whether the below-market rates these interests enjoy are in the public interest. British Columbian forestry expert Peter Pearse has noted that "[t]here will always be these uncertainties unless you put things up for bid. I think the only true way to safeguard the public interest is to put some of these operations up for sale." The article quoting Pearse ended by noting: "But that's undoubtedly a prescription COFI (the Council of Forest Industries) would find hard to swallow."

Indeed it is. And until they do swallow a market system, we must continue to maintain a mechanism to countervail their subsidies. That mechanism is the MOU.

What is needed is heightened enforcement of the MOU's terms. The Coalition has documented Canadian attempts to evade the agreement.

In some cases exporters have been caught red-handed. In October 1990, for example, Revenue Canada announced that several Canadian exporters had been avoiding the export tax by misclassifying their lumber as remanufactured. Remanufactured lumber is subject to a different -- and lower -- tax than normal softwood lumber.

Some statistics suggest the extent of export tax fraud. For example, in several provinces, collections consistently have fallen short of target collections. The shortfall was in the millions of dollars.

The Coalition is not asking for retaliatory action against these and other Canadian breaches. Congress should, however, be aware that MOU enforcement in Canada is not perfect. The MOU is being being nibbled apart by ducks. I suppose that we should be happy we are not being stampeded by elephants. But as the Canadians call for the MOU's elimination, keep this history of evasion attempts in mind. Strong enforcement of the MOU, not its elimination, is the wiser public policy.

The MOU is that rarest of birds: A trade agreement that accomplished what it set out to do. It partially offset Canadian subsidies that were devastating U.S. companies. This is turn has led to a reduction in Canada's penetration of the U.S. lumber market.

The Canadians cannot point to any legitimate reasons why the MOU should be eliminated. It is understandable that Canadian industry would prefer the old days of unbridled subsidization. But they have no right to export subsidized lumber to the United States."

So I say to the U.S. Government: If the MOU ain't broke, don't fix it. Furthermore, beware of events in other fora -- the GATT Subsidies Code and the U.S.-Canada-Mexico Free Trade Agreement negotiations come to mind -- that might provide opportunities to undermine the MOU.

On behalf of the Coalition, I urge the Congress and the Administration to resist Canadian attempts to eliminate the MOU. Don't let them once again use subsidies to devastate U.S. workers and the communities that depend upon them.

Thank you for the opportunity to testify.

**COALITION FOR FAIR LUMBER IMPORTS**
C. T. "Kip" Howlett, Jr., Chairman

# U.S.-CANADA SOFTWOOD LUMBER MEMORANDUM OF UNDERSTANDING

## CONGRESSIONAL BRIEFING BOOK

FEBRUARY 22, 1991

**1775 Pennsylvania Avenue, N.W., Suite 600 • Washington, D.C. 20006 • (202) 862-4505**

National Forest Products Association • Northeastern Lumber Manufacturers Association, Inc. • Northwest Independent Forest Manufacturers •
Southeastern Lumber Manufacturers Association • Southern Forest Products Association • Western Forest Industries Association • Western Wood Products Association

## U.S.-CANADIAN SOFTWOOD LUMBER AGREEMENT: SUMMARY OF THE REPORT: PAST, PRESENT, FUTURE

On December 30, 1986, the United States and Canada signed a Memorandum of Understanding ("MOU") that offset Canadian timber subsidies that had seriously injured U.S. softwood lumber producers. Four years later, it is appropriate to take stock of the successes and failures of the agreement, and to determine how best to continue to implement the letter and spirit of the agreement -- to offset effectively Canadian timber subsidies -- in light of current economic and political pressures.

**The Problem**: The Canadian lumber industry benefits from access to government timber at below-market fees. In Canada, even today over 85% of timber is sold under an administered price system designed to create jobs regardless of the market value of timber. By contrast, timber in the United States is sold competitively.

**The Result**: By 1986, U.S. firms were paying up to ten times the amount paid by Canadian firms for similar timber. The Canadian timber subsidies continue, although partially offset by the MOU.

**Injury to U.S. Industry**: The stumpage subsidies enabled Canadian producers to nearly double their U.S. market share over a ten-year period. By the summer of 1986, Canada had captured more than one third of the U.S. market. As a result, despite relatively equal rates of productivity and efficiency in Canada and the United States, hundreds of U.S. mills were driven out of business and tens of thousands of workers lost their jobs.

**The Solution**: In 1986, the U.S. industry successfully filed a countervailing duty case against the Canadian subsidies. The MOU offset the countervailing duty by imposing a 15% tax on Canadian lumber exported to the United States. The MOU's partial subsidy offset has enabled the U.S. industry to recapture some market share and employment that had been lost to subsidized Canadian imports. Yet, the Canadian lumber industry has not been seriously impaired, although some readjustment in market share necessarily occurred once the effects of Canadian subsidies were reduced.

**Recent Canadian Efforts to Avoid Their Obligations**: Canadian calls to renegotiate or withdraw from the MOU are disturbing. Complaints that the MOU is unsupportable as a matter of public policy are groundless. The MOU is a necessary response to injurious Canadian practices and is based on a solid legal and factual foundation. As some Canadian lumber companies apparently continue to evade the MOU's disciplines, strict enforcement of the MOU, not its abrogation, should continue as a U.S. priority.

**The Future**: In the coming months, the U.S. Government must (1) continue to enforce the MOU; (2) resist Canadian pressures to eliminate the MOU outright; and (3) beware of a GATT agreement that could weaken essential U.S. trade laws.

## U.S-CANADA SOFTWOOD LUMBER AGREEMENT: SECTION I: THE PROBLEM

> WE WEREN'T CHARGING FOR TREES AND THEY HAD A COMPETITIVE BIDDING SYSTEM ON THEIR PUBLIC LANDS THAT SOMETIMES HAD THEIR COMPANIES PAYING TEN TIMES WHAT OUR COMPANIES WERE PAYING FOR THE SAME TIMBER. THE AMERICANS SAW THIS AS A SUBSIDY -- AND THEY WERE RIGHT. COUNTLESS CANADIAN ACADEMICS HAD SAID THE SAME THING IN QUIET SCHOLARLY JOURNALS.

- Bob Williams
Former Minister of Forests
British Columbia
The Undercurrent (Bowen Island, B.C.)
February 13, 1987

> IN THE END, SYMPATHETIC ADMINISTRATION SERVED ONLY TO WASTE A LOT OF GOOD WOOD, SAVE FEW JOBS AND PUSH MORE FOREST PRODUCTS ONTO AN ALREADY GLUTTED MARKET.

- "Fear in the Forests"
British Columbia Report
October 8, 1990

The 1986 Softwood Lumber Memorandum of Understanding ("the MOU") is necessary for a very simple reason: **Canadian provincial governments provide timber to their lumber companies at fees set far below the prevailing market rates.**

These timber subsidies are intended to encourage employment and production where the market would not otherwise permit it:

> The U.S. has generally sought to capture economic rents from public timberlands through competitive bidding, whereas Canada has used long-term noncompetitive tenures for Crown forest lands to support regional development objectives.

T. Waggener, Forests, Timber, and Trade 23 (December 1990). Canadian companies have used this natural resource subsidy to win market share and boost profits. Unchecked, this practice had devastated the U.S. industry.

Stumpage -- the fee charged for the right to cut timber -- comprises a significant percentage of the overall cost of lumber production in competitive markets. Thus, a stumpage subsidy is a very effective tool to create an artificial advantage.

## The U.S. System

**In the United States, industry must bid competitively for almost all government- and privately-owned timber.**

- Two-thirds of timber is privately-owned and marketed.
- In U.S. Forest Service sales, which comprise the bulk of the remaining timber supply, a minimum acceptable bidding price (based on average operating costs) is set. Then, lumber companies bid competitively for the cutting rights in an auction, usually driving the actual bid price -- the market value -- well above the minimum bid price.

## The Canadian System

In Canada, however, **the national and provincial governments own nearly all the timber and sell it non-competitively at below-market rates.**

- Over 90% of Canadian timber is owned by Canadian governments.
- In 1986, more than 90% of all timber was sold in a non-competitive market.

In 1990 **British Columbia** produced over 70% of the Canadian softwood lumber exported to the United States. British Columbia once had operated its system by market principles but **introduced a non-competitive administered pricing system under pressure from the major forest companies:**

> Thirty years ago, over the roared protests of ... the province's independent loggers, the major forest companies, which now dominate the industry, persuaded the government of the day to see the world through their eyes. The most fundamental principle of free enterprise -- open market competition -- was eliminated from B.C.'s forest industry insofar as the supply and cost of raw materials was concerned. The best farm land was parcelled into fiefdoms known as Tree Farm Licenses. Most of the remaining timber was allocated to established logging companies under the "quota" system.

Equity, April 1984. In 1986, the Comox District Free Press (Courtenay, B.C.) noted the **abuses engendered by this system:**

> ... the U.S. puts its state forest cutting rights up for bid, while B.C. signs cushy almost sweetheart long-term leases to a handful of big firms and then looks the other way when the companies don't fulfill their obligations to log properly and reseed adequately and

maximise fibre yields and so on. The egregiously bad situation can be summed up thusly: B.C. forest exports alone are worth an incredible $6.3 billion [$Can] a year but the province collects just $144 million [$Can] in forest resource revenues while spending $347 million [$Can] to run the forests department. Obviously something is rotten in Denmark.1/

**The system remains alive today.** In December 1990, Forest Planning Canada noted that "Timid recommendations ... to re-introduce a partial competitive market for public timber and to further restrict log exports are being met with disdain by this province's powerful forest industry lobbying group, the Council of Forest Industries (COFI)."

**Small B.C. loggers often complain bitterly about the allocation system:**

- They often must rely on competitively-sold timber for their livelihood -- timber that is significantly more expensive than that procured under the "cushy" deals cut by the powerful forest companies.

- Small loggers harvest less than 1/6 of B.C. timber yet pay nearly 1/3 of overall stumpage fees. The large integrated companies' response -- that expenses for silviculture, road-building and other fees more than make up for this gap -- are inadequate. Even with these deductions the smaller loggers still pay significantly more because their timber is purchased competitively. See attached article.

**Other provinces also operate by an administered pricing system:**

- A June 1985 report by an Ontario Royal Commission on the Northern Environment noted that "[t]here is no public tendering process. . . . Stumpage fees do not reflect the market value of timber cut."

- A report by the Quebec Government noted that management of timber cutting on public lands should aim to achieve "social" objectives such as maintaining employment -- objectives incompatible with a market pricing system. See The Role of Economic Analysis in Forest Sector Decisions, Government of Quebec, May 1985.

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1/ Figures are in U.S. dollars unless otherwise noted.

## Cross-Border Comparisons

The result of the cozy relationship between major firms and many of the Canadian provinces: **Canadian firms immediately north of the border were paying in 1986 a fraction of what U.S. firms had to pay for virtually identical timber.** Stumpage in the Canadian provinces that operated by an administered price system consistently was ten times less than comparable U.S. timber. See Chart 1.

A side-by-side comparison of the same stand of timber in Idaho by B.C. and U.S. appraisers conducted in October 1985 confirmed this. The U.S. appraiser valued the stand for minimum bid purposes at over $14/Thousand Board Feet (MBF) whereas the B.C. appraiser appraiser valued the stand at about $4/MBF. Bidding on the U.S. stand would have raised the actual market price to around $41/MBF -- ten times the amount a B.C. forest company would pay.

## Cross-Border Stumpage Comparisons After the MOU

It is important to recognize what the MOU did not accomplish: It did not require Canada to adopt a competitive bidding system and it did not equalize Canadian and U.S. stumpage rates on comparable timber. The MOU only required that through the export tax or replacement measures Canadian firms pay the equivalent of a 15% duty on lumber based on the subsidy determination made by the Department of Commerce.

**Even today, after the implementation of the MOU, many Canadian stumpage fees (even with the tax) continue to be set lower than market rates, providing Canadian companies with an ongoing advantage:**

- In British Columbia, Canada's largest producer of softwood lumber, stumpage fees on timber sold competitively have soared far beyond collections from administered-price stands. In the B.C. interior, for example, competitive stumpage collections averaged approximately $\$18/m^3$ for the 2nd quarter of 1990 while non-competitive stumpage collections averaged roughly $\$8/m^3$ [$Can]. See Charts 2 and 3. While differences in the timber sales might justify some small difference in price, it cannot account for this enormous difference.

- Average 1990 U.S. stumpage collections on the west side (coastal region) of Washington state were $225.36/MBF -- significantly higher than the $48.72/MBF collected under the administered price system in the B.C. Coastal region. See chart 4.

- Average collections on the east side (interior region) of Washington state were $92.54/MBF, compared to the $38.85/MBF collected under the administered pricing system in the B.C. Interior. See chart 4.

- A revealing (although somewhat crude) chart prepared by Forest Planning Canada shows that timber fees in the U.S. Pacific Northwest are consistently and significantly higher than B.C. timber fees even after British Columbia dramatically increased timber fees to replace the MOU's export tax. See Chart 5.

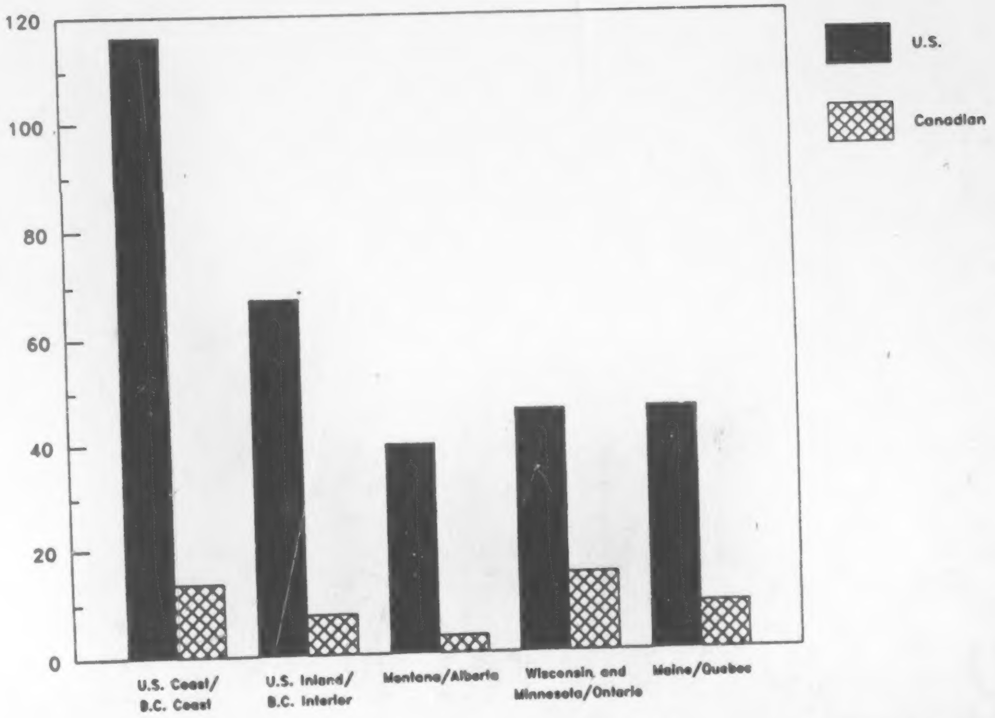
- In the United States since the adoption of the MOU, stumpage prices have dramatically escalated because of market conditions. This is particularly true in the Northwest where environmental concerns may seriously limit timber supply. In a free market, the price of timber in Canada because of these market pressures. Unfortunately, the administered pricing system continues in almost all provinces.

As a result, U.S. companies continue to face competition that does not play by the market rules. In the face of a timber industry recession, the effect could be magnified if the MOU is not enforced vigorously.

Chart 1

## U.S./Canadian Fees on Comparable Timber, 1985

($/MBF Log Scale Scribner)

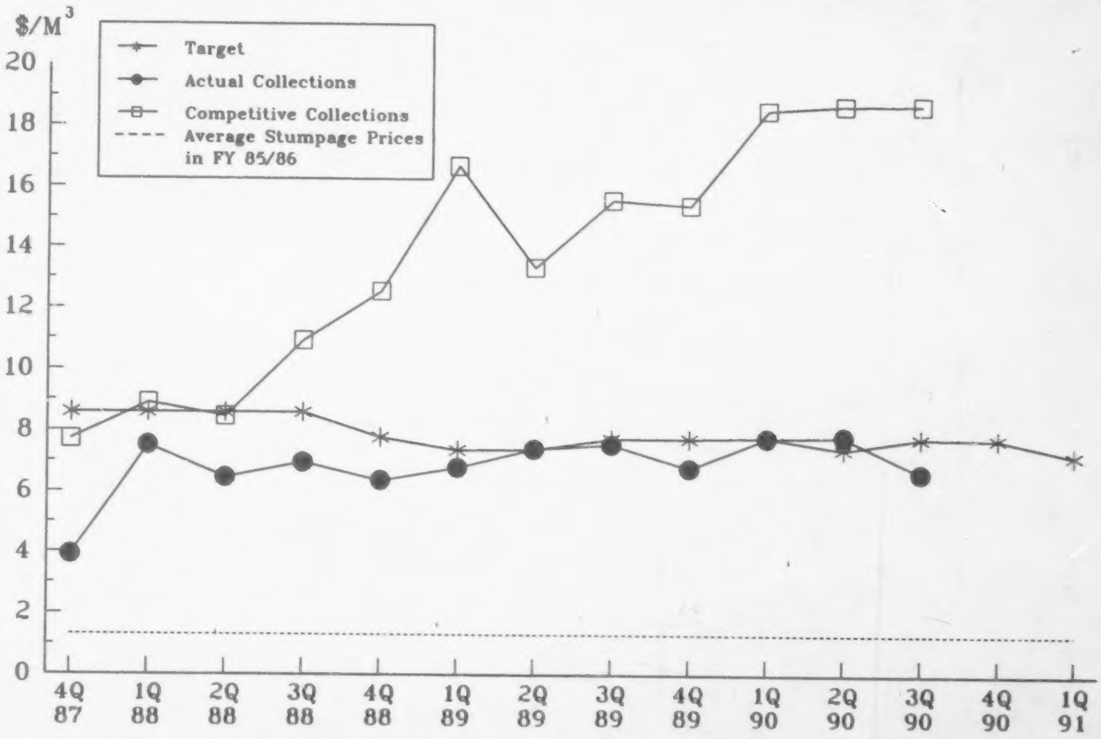


Sawtimber Cross-Border Comparison, 1985
($/MBF log scale Scribner)

| Area Compared (U.S./Canada) | U.S. | Canada | Difference |
|---|---|---|---|
| U.S. Coast/ B.C. Coast | $116.34 | $13.29 | $102.05 |
| U.S. Inland/ B.C. Interior | $ 67.23 | $ 7.33 | $ 59.90 |
| Montana/Alberta | $ 48.20 | $ 3.16 | $ 45.04 |
| Wisconsin and Minnesota/Ontario | $ 45.72 | $14.36 | $ 31.36 |
| Maine/Quebec | $ 45.96 | $ 8.60 | $ 37.36 |

Chart 2

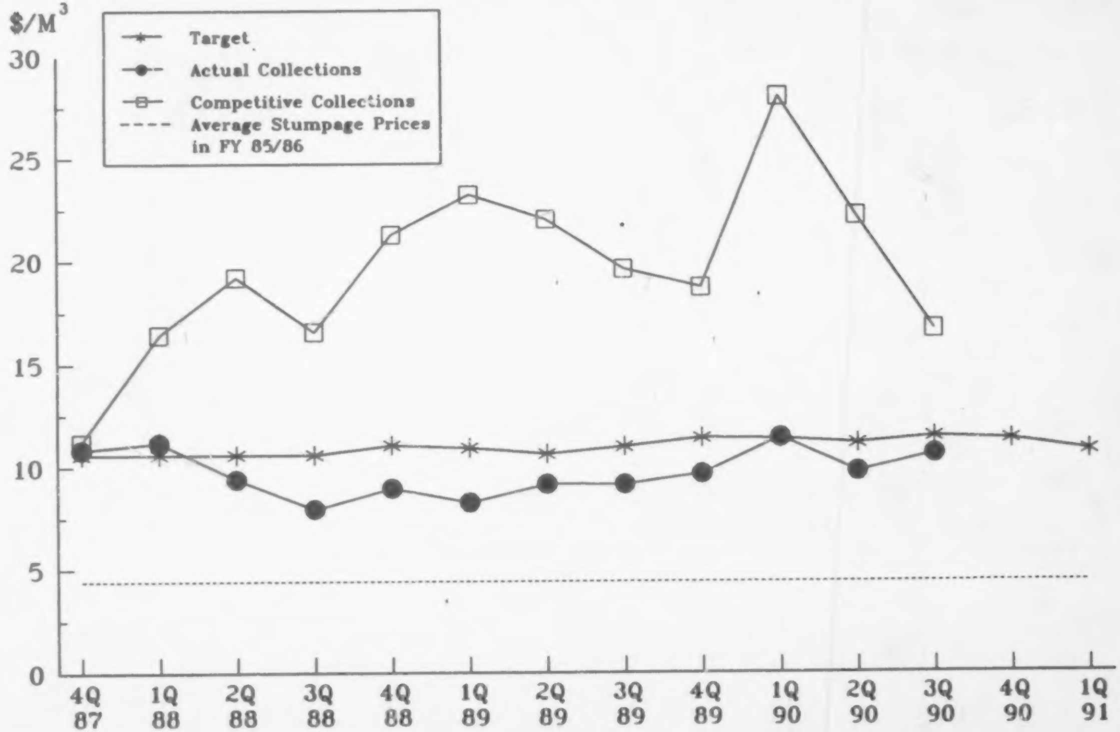
# B.C. INTERIOR STUMPAGE COLLECTIONS



Note: Dotted line represents average B.C. stumpage prices in the interior for 1985–1986: $1.31 CDN.

Chart 3

# B.C. COASTAL STUMPAGE COLLECTIONS

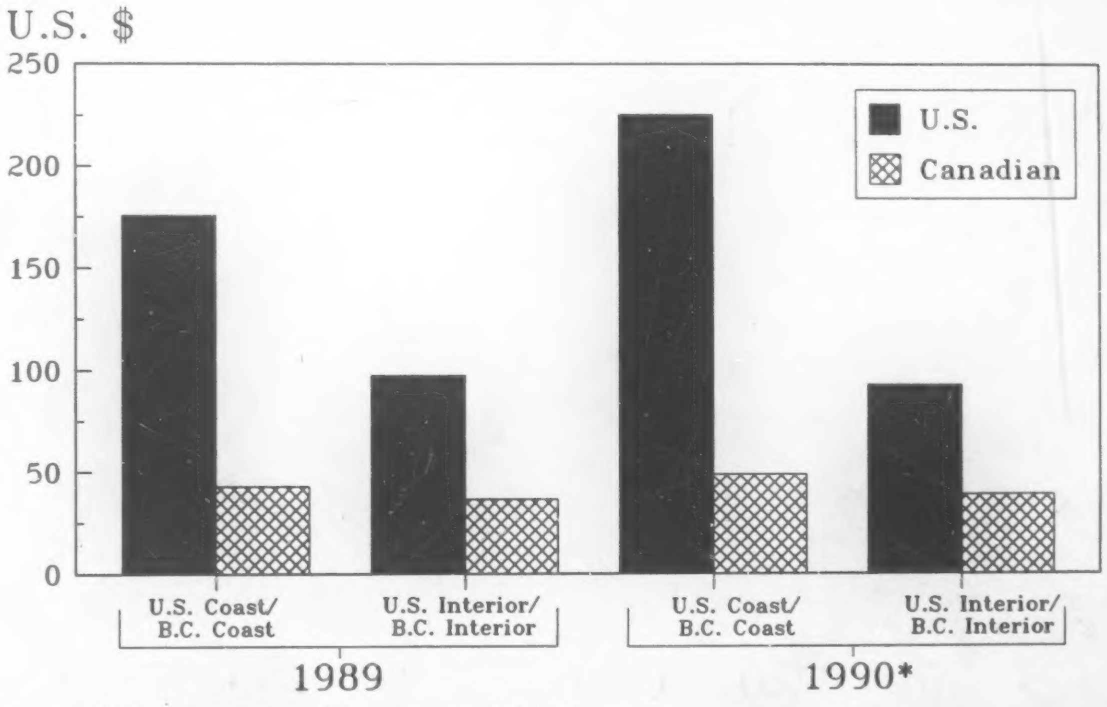


Note: Dotted line represents average B.C. stumpage prices on the coast for 1985-1986: $4.41 CDN.

Chart 4

## U.S./CANADIAN FEES ON COMPARABLE TIMBER, 1989–1990

(\$/MBF Log Scale Scribner)



* B.C. 1990 data is based on data from the first three quarters.

# COMPARISON OF AVERAGE STUMPAGE RATES IN WASHINGTON AND BRITISH COLUMBIA

| | 1989 | 1990 |
|---|---|---|
| **WASHINGTON<br>EAST SIDE (INTERIOR)** | | |
| TOTAL VOLUME (MBF) | 377,025 | 246,859 |
| AVERAGE STUMPAGE (US$/MBF) | $97.46 | $92.54 |
| **WASHINGTON<br>WEST SIDE (COAST)** | | |
| TOTAL VOLUME (MBF) | 631,161 | 451,343 |
| AVERAGE STUMPAGE (US$/MBF) | $175.45 | $225.36 |

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| | 1989 | 1990* |
|---|---|---|
| **BRITISH COLUMBIA<br>INTERIOR** | | |
| TOTAL VOLUME (MBF) | 6,613,115 | 4,391,639 |
| AVERAGE STUMPAGE | | |
| (CDN$/MBF) | $43.13 | $45.45 |
| (US$/MBF) | $36.55 | $38.85 |
| **BRITISH COLUMBIA<br>COAST** | | |
| TOTAL VOLUME (MBF) | 3,096,002 | 1,788,878 |
| AVERAGE STUMPAGE | | |
| (CDN$/MBF) | $50.37 | $57.00 |
| (US$/MBF) | $42.69 | $48.72 |

* B.C. 1990 data is based on first three quarters.

SOURCES:
WASHINGTON -- U.S. Forest Service
BRITISH COLUMBIA -- B.C. Government Data

Chart 5

# Volumes logged and revenue benefits, U.S. National Forests versus B. C. public lands, 1988/1989

| | Volume Logged (million cubic metres) | Total Revenue from timber sales (per cubic metre) | Timber Revenues Paid Directly to County/ Municipal Governments (per cubic metre) | Net Revenues from National Forest and B.C. timber sales (per cubic metre) |
|---|---|---|---|---|
| Tongass, Alaska NF | 1.9 | $12.79 | $3.02 | $3.77 |
| Prince Rupert Region BC | 15.7 | $4.12 | none | ($1.55) |
| Olympic NF | 0.8 | $39.71 | $10.54 | $18.35 |
| Mt. Baker NF | 0.8 | $49.96 | $11.82 | $29.35 |
| Vancouver Region BC | 24.8 | $5.94 | none | ( $0.67) |
| Okanagan NF | .5 | $27.74 | $6.52 | $13.99 |
| Colville NF | .6 | $21.56 | $4.85 | $7.79 |
| Kamloops Region BC | 8.6 | $7.80 | none | ($0.06) |
| Panhandle NF | 1.2 | $24.93 | $5.07 | $10.55 |
| Kootenai NF | 1.0 | $18.87 | $3.66 | $3.64 |
| Flathead NF | .4 | $18.62 | $3.95 | ( $2.83) |
| Nelson Region BC | 7.1 | $5.76 | none | ($0.62) |
| Prince George Region BC | 15.3 | $11.17 | none | $4.11 |
| Cariboo Region BC | 9.1 | $5.08 | none | ($1.13) |
| **Summaries** | | | | |
| All Washington State NFs | 5.5 | $39.86 | $9.54 | $22.80 |
| All Idaho NFs | 3.5 | $19.85 | $4.05 | $5.01 |
| All Montana NFs | 2.3 | $16.43 | $3.28 | ($4.20) |
| All U.S. NFs Nationwide | 54.2 | $32.76 | $7.32 | $16.00 |
| All B.C. Public (Crown) Forests | 75.6 | $8.25 | none | $1.88 |

Note: NF = National Forest; BC = British Columbia; ( ) indicates a negative or deficit number. Net = Revenues minus costs. Source: Timber Sale Program Information Reporting System (TSPIRS) (1988/89), U.S. Forest Service; Ministry of Forests, British Columbia, Annual Report (1988/89). B.C. logged 75.6 million cubic metres of public timber and produced net revenue of $1.88 per cubic metre. The NFs, on adjacent states, logged 13.4 million cubic metres and produced net revenue of $10.53 per cubic metre. Major differences between the two jurisdictions are competitive bidding on all NFs, major roads on NFs are amortised over full rotation, silviculture and roads partly paid for by B.C. companies, and 25 % of NF gross revenue paid to counties. In 1984, TSPIRS was mandated by the U.S. Congress to require the USFS to address the issue of "below-cost" (where revenues are below the costs of timber sales). The question of most appropriate "revenue-cost assumptions" is controversial both in the U. S. and Canada. In FPC's analysis, the TSPIRS appears to be the most acceptable measure to date. TSPIRS is a procedure used to help make better forest economic decisions. B.C. costs include Victoria "overhead" of $1.88. In the adjoining States, National Forests comprise only about 27 per cent of the total state-wide forest land base.

# Stumped by unfair fees

*Small logging firms say they've got the short end of the stick*

Small logging companies have long contended they haven't been given a fair shake. Far too much of the province's forest harvest has been handed to the large integrated companies, they argue. On that score, nothing much has changed, but the small loggers now have a new gripe, as well. The stumpage system introduced in 1987 discriminates against them by requiring them to pay higher levies than the big companies, even though the harvest assigned them by Victoria is much smaller. The major forestry companies retort that the comparison isn't valid. But critics point out the disparity just proves the need to radically revamp not just stumpage fees, but the entire tenure system in B.C.'s forests.

Figures released by the Ministry of Forests reveal that the majors cut more than 56 million cubic metres of wood last year, paying a total of $434 million in stumpage fees. A far smaller share of the annual harvest, around 9.2 million cubic metres, was allocated to companies under the Small Business Forest Enterprise Program (SBFEP), which is restricted to firms with less than 10,000 metres of annual allowable cut.

But although they had less than one-sixth the harvest of the majors, the small companies sent almost a third as much—$134 million—to provincial coffers.

Unlike the timber harvested by the major forestry companies, the SBFEP cut is open to competitive bidding. The province sets a minimum stumpage charge, called an upset bid, and the companies then submit "bonus bids" above the upset. But the formula used to assess stumpage for the big companies is quite different. No competitive bidding takes place. Instead, the company simply has to meet the government's upset figure. The resulting stumpage rates, as might be expected, usually range much lower than those received from small businesses. For example, in the Vancouver region (B.C.'s largest in terms of timber harvested), the major companies paid an average stumpage of $8.53 per cubic metre—less than half the $18.79 paid by the small companies.

But Hartley Lewis, director of the forests ministry's timber valuation branch, says it isn't fair to compare the rates. First, he says, the quality of timber may not be the same, although he admits that it is ministry policy to have stands of roughly equal quality assigned to the two groups. Second, the large companies have to assume major expenses such as silviculture and road-building, while the province picks up the tab for smaller companies. "The small business program doesn't have any of those responsibilities," Mr. Lewis explains. "It's much more expensive for us to run."

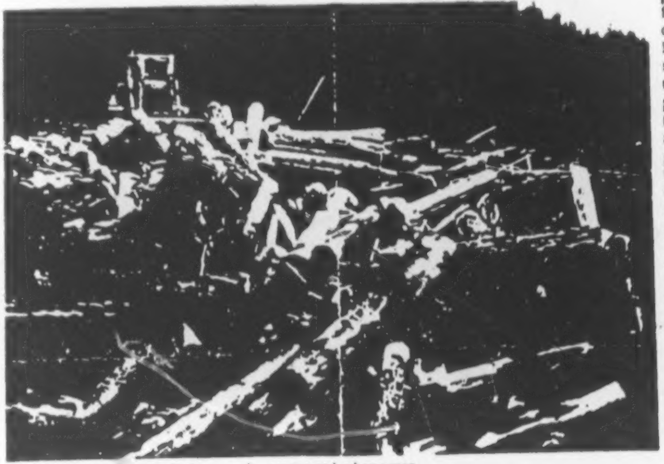
The Council of Forest Industries (COFI), which represents the large integrated companies, says these expenses are so significant that their companies actually pay more per cubic metre. According to COFI calculations, when basic reforestation, road-building, and administrative costs are figured, the majors actually pay $20 per cubic metre, compared with $18 by small businesses.

These arguments, however, don't impress Fred Marshall, a Greenwood consulting forester. "That's bull —," he says. "Those forest costs are all appraised and stumpage is reduced accordingly." And provincial government figures seem to lend some credence to Mr. Marshall's contention. Even after reforestation, road-building, and other administrative expenses are deducted from the total stumpage paid by small companies, the average stumpage works out to $9.55, still significantly higher than the $7.69 the majors pay.

Mr. Marshall blames the present tenure system for the disparity. Sawmills operated by the majors need more timber than they can get through their own tenures, so they purchase wood from the smaller companies—at high prices. The mills are willing to pay such high prices because they are paying artificially low prices on the vast tracts of forest they hold free from competition. Mr. Marshall says that in order to get at the incremental timber, the big companies often set up a "surrogate bidding" arrangement whereby they formally, or informally, arrange to make high bids through a smaller company at small business auctions. This practice, he says, is "completely against the spirit of the small business program."

Critic Marshall feels the only remedy is for the government to take away a large portion of the harvest currently under long-term tenure to the majors. A better division, he suggests, would be 50% to the majors, 25% to communities, 20% to small business, and 5% to the woodlot program. "You've got to split up the tenures," he says. His ideas are nothing new. University of British Columbia forestry professor Peter Pearse advocated sweeping changes to the tenure system in his 1976 Royal Commission report on forestry. "There will always be these uncertainties unless you put things up for bid," he says. "I think the only way to truly safeguard the public interest is to put some of the operations up for sale." But that's undoubtedly a prescription COFI would find hard to swallow.

— *Tom McFeely*



**B.C. logging:** *For the little guys, less trees at higher rates*

## U.S-CANADA SOFTWOOD LUMBER AGREEMENT: SECTION II: INJURY TO U.S. INDUSTRY

Since timber, bought at market prices, comprises almost one-half of the cost of commodity lumber in competitive markets, the Canadian stumpage subsidies severely harmed U.S. producers. **In spite of world-class rates of efficiency and productivity, U.S. market share steadily declined in the decade between 1976 and 1986 as subsidized Canadian lumber producers pummelled the U.S. softwood lumber industry:**

- Canadian lumber took an ever-increasing share of the U.S. market, reaching almost one-third in 1985 (up from just over the 20% average market share logged from 1970 through 1976). See Chart 6. (The 1986 figures were depressed by a strike in British Columbia that temporarily cut Canadian production.)
- Overall Canadian lumber production jumped from 14.9 billion board feet in 1976 to 22.3 billion board feet in 1985, while U.S. production increased only slightly from 29.7 to 30.6 billion board feet. See Chart 7.

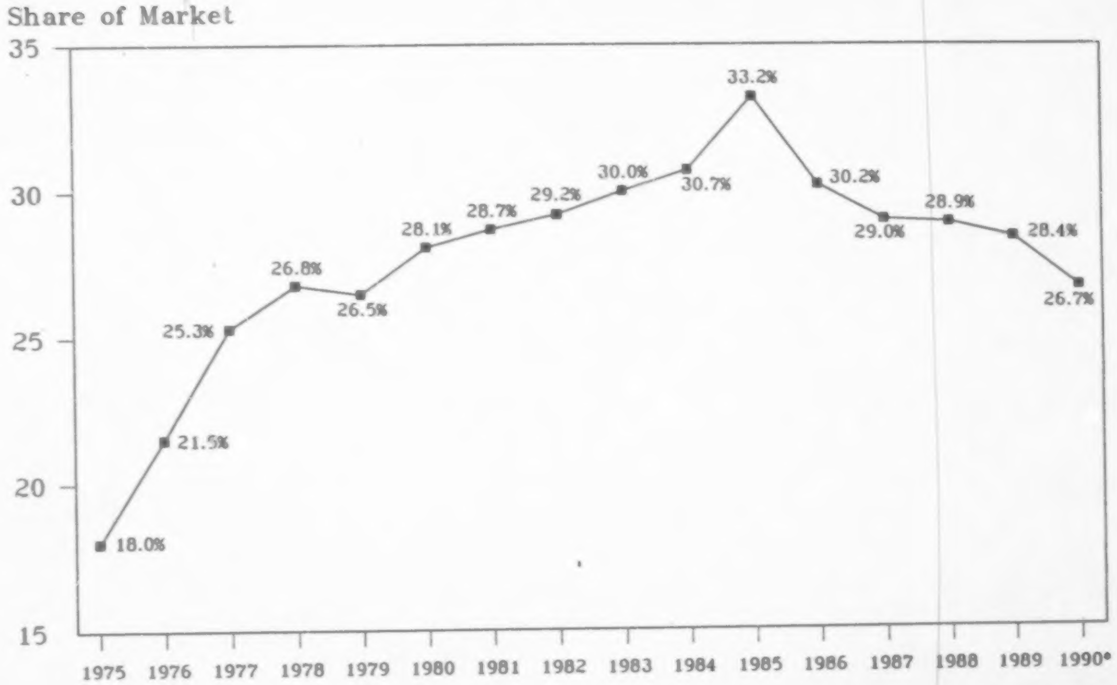
Effect on North American Industry:

- **Between 1977 and 1984, the International Trade Commission reported that the U.S. lumber industry closed 629 mills and reduced its workforce by over 30,000 workers.** During the same period, Canadian producers opened 85 new softwood mills.
- The U.S. industry bled hundreds of millions of dollars in red ink, facing $300 million in pretax losses in 1984 alone.

Only the adoption of the MOU arrested the growth of subsidized Canadian lumber.

Chart 6

## CANADIAN PENETRATION OF U.S. SOFTWOOD LUMBER MARKET



Source: National Forest Products Association

* Data for 1990 is only through October 1990.

Chart 7

## VOLUME OF LUMBER PRODUCTION
## (BILLION BOARD FEET)

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| CANADA | 10.8 | 12.3 | 13.4 | 15.0 | 13.0 | 10.9 | 14.9 | 17.2 | 18.4 | 18.6 | 18.3 | 16.6 | 15.9 | 20.3 | 20.6 | 22.3 | 22.0 | 25.9 | 25.3 | 24.1 | 15.7 |
| UNITED STATES | 27.4 | 29.7 | 30.9 | 31.3 | 27.2 | 25.7 | 29.7 | 31.8 | 31.9 | 31.4 | 26.2 | 24.7 | 23.8 | 29.7 | 31.2 | 30.6 | 35.3 | 38.2 | 38.1 | 37.5 | 25.4 |
| CANADIAN SHARE OF TOTAL N.A. LUMBER PRODUCTION | 28.3% | 29.3% | 30.3% | 32.4% | 32.3% | 29.8% | 33.4% | 36.5% | 35.1% | 37.2% | 41.1% | 40.2% | 40.1% | 39.8% | 41.7% | 40.6% | 38.4%[1] | 40.4% | 39.9% | 39.0% | 38.3%[2] |

Source: Western Wood Products Association Dominion Bureau of Statistics

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[1] Canadian share of lumber production dropped in 1986 because of a lumber strike in British Columbia.

[2] Canadian share of lumber production in 1990 is the lowest it has been since 1979.

## U.S-CANADA SOFTWOOD LUMBER AGREEMENT:
## SECTION III: THE SOLUTION -- THE MOU

In 1986, facing disaster despite record demand and having failed in efforts to negotiate an end to Canadian subsidies, the Coalition for Fair Lumber Imports -- supported by a broad spectrum of the U.S. industry -- filed a countervailing duty case against Canadian timber subsidies.2/

In October of 1986, after extensive litigation, the Department of Commerce found Canadian lumber benefitted from a 15% subsidy and imposed a preliminary countervailing duty of 15% to offset that subsidy. This tariff would have raised more than $500 million annually.

Rather than allowing the United States to collect the subsidy offset, Canada sought to settle the case. The result was the MOU, which permitted Canada:

- to impose a 15% export tax on goods, or
- to increase timber fees to "replace" the export tax. To replace the tax, the stumpage increase must have an equivalent economic impact at the border to the tax.

The U.S. industry -- while it believed that the 15% tax was only a partial subsidy offset -- agreed to this settlement, dismissing its countervailing duty case, on the basis of commitments for strict enforcement of the MOU.

The strong commitments were given by President Reagan. The President determined that any breaches of that agreement would violate Section 301 of the Trade Act of 1974. The President further committed to take prompt action under Section 301 to remedy any such breaches identified by the Secretary of Commerce, promising to

> take action (including the imposition of an increase in the tariff on softwood lumber imported from Canada) to

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2/ The Coalition is comprised of seven associations -- National Forest Products Association, Northeastern Lumber Manufacturers Association, Inc., Northwest Independent Forest Manufacturers, Southeastern Lumber Manufacturers Association, Southern Forest Products Association, Western Forest Industries Association, and the Western Wood Products Association -- as well as dozens of individual corporations, including Georgia-Pacific, International Paper, Potlach, and Temple-Inland.

offset any shortfall in the full imposition of the export charge or of the replacement measures therefor.

By the end of 1987, British Columbia, the largest Canadian producer of lumber, had implemented a full replacement measure. Thus, while B.C. timber fees have increased, there is no tax on B.C. lumber. Quebec, the second largest producer, has implemented a partial replacement measure. The Maritime Provinces were excluded from the MOU because the vast bulk of their timber is sold competitively. Ontario, Alberta, Manitoba, and Saskatchewan continue to be subject to the full 15% export tax.

## THE MOU HAS BENEFITTED THE NORTH AMERICAN LUMBER INDUSTRY

Overall, **the adoption of the MOU has resulted in a more level playing field that has been good for the North American lumber industry.** Market shares have been readjusted and now reflect more faithfully the comparative competitiveness of the two industries:

- Efficiency and productivity replaced subsidization as the primary arbiters of success.
- **The U.S. lumber industry has prospered under the more competitive market conditions ushered in by the MOU:**
  - The Canadian share of North American lumber production is the lowest it has been since 1979, dropping from its peak in the summer of 1986 of about 35% to roughly 27% for 1990.
  - The number of employees in U.S. sawmills and planing mills alone increased by almost 15,000 workers between 1985 and 1990. *See* Chart 8. Thousands of other jobs have been created in logging, forestry, and related industries.
  - U.S. exports to Canada increased by 60% between the first eight months of 1986 and the first eight months of 1990 (from 1,263 MMBF to 2,018 MMBF).
  - Eliminating stumpage subsidies has benefitted U.S. industry without hurting U.S. consumers. A 1986 Congressional Budget Office study found that the average new home price would increase by only $300 *if* the 15% were completely passed on to the consumer -- an unlikely event. Even assuming the $300 increase, this would be only pennies per month amortized over the life of a mortgage.

- **The Canadian lumber industry has not been severely hurt by the MOU and indeed prospered before the onset of the North American timber industry recession of the last two years.** In the years immediately following the Agreement, the volume of worldwide Canadian exports grew and the volume of Canadian exports to the United States remained stable:
    - Canadian exports to the U.S. market stabilized after the adoption of the MOU. In 1989, the United States imported 13.5/billion board feet of Canadian softwood lumber -- more than in any other year excepting 1985, which was the peak year of the subsidized Canadian import surge. See Chart 9.
    - In 1987 and 1988, British Columbia's forest products industry enjoyed record earnings and more profitable years than in any year between 1974 and 1986, according to Price Waterhouse. (While lower lumber profits were reported, the integrated companies could manipulate these profits through transfer pricing. Overall, the largely integrated Canadian industry showed record profits.)
    - Worldwide Canadian lumber exports increased by one billion board feet between the first nine months of 1986 and the first nine months of 1988. ("Hit Hard by Softwood? The Industry Says It's Hurting, But the Stats Say Otherwise," Western Report, January 15, 1990.)
- **The MOU has helped to equalize the pain of the current recession**, which has hit both U.S. and Canadian producers hard:
    - In 1990, in the U.S. Northwest (Idaho, Oregon, and Washington) alone, U.S. industry was forced to close a total of 21 sawmills, eleven in Oregon. "Northwest Closures Set Record," Random Lengths, January 25, 1991.
    - Lumber production in both the United States and Canada is dropping. See Chart 9. This in large part reflect the sharp drop in housing starts.
    - This situation contrasts with the last recession, when stumpage subsidies enabled Canadian producers to gain market share in the United States -- notwithstanding comparable rates of efficiency and productivity with U.S. industry.

## THE MOU PROMOTES CONSERVATION AND REFORESTATION

> WE TAKE THE STAND THAT STUMPAGE RATES ARE TOO LOW. YOU CAN'T CARRY ON GOOD REFORESTATION WITH THE KIND OF INCOME THEY (THE PROVINCIAL GOVERNMENTS) ARE GETTING FROM THE LOGS.
>
> \- Tom Gorman
> President
> Gorman Brothers Lumber
> Kelowna (B.C.) Daily Courier
> October 7, 1986.

> ... THE PRICE OF LOGS IS ARTIFICIALLY LOW. AND BECAUSE THE PRICE DOES NOT REFLECT THEIR TRUE VALUE, THERE IS NO PRESSURE TO GET THE MAXIMUM RETURN FROM EACH LOG... IT'S NOT SURPRISING THAT AN AMERICAN MILLER WHO IS PAYING A HELL OF A LOT MORE FOR STUMPAGE IS GOING TO BE MORE CAREFUL ABOUT WHAT THEY [SIC] GOT OUT OF A LOAD OF LOGS.
>
> \- Peter Pearse
> Professor of Forestry
> University of British Columbia
> "Are B.C.'s Logs Priced Too Low?"
> The Globe and Mail
> May 20, 1989

**The MOU has encouraged environmentally sound forestry practices in North America:**

- U.S. companies that pay much more for their logs tend to use much more of each equivalent log than do their Canadian counterparts, according to Canadian forestry expert Peter Pearse. See attached article.

- In British Columbia, logging has far outpaced the estimated sustainable yield. After the imposition of the MOU, B.C. logging began to come back towards sustainable yield levels. See attached article.

- Prior to the MOU, the provincial governments collected less in stumpage revenues than they spent for conservation and reforestation. As the Canadian newspaper Western Report observed on October 27, 1986:

> If British Columbia's forest resource is indeed renewable, the stumpage ought to pay at least for the renewal. Thus, the U.S. Forest Service builds its own operating costs into the pricing system as a minimum acceptable bid. In 1985, for example, the U.S. service sold $721 million [$Can] worth of timber, while its operating costs stood at $274 million [$Can]. B.C.s' forest management programs cost $335 million [$Can] in 1985. Revenues came to $185 million [$Can].

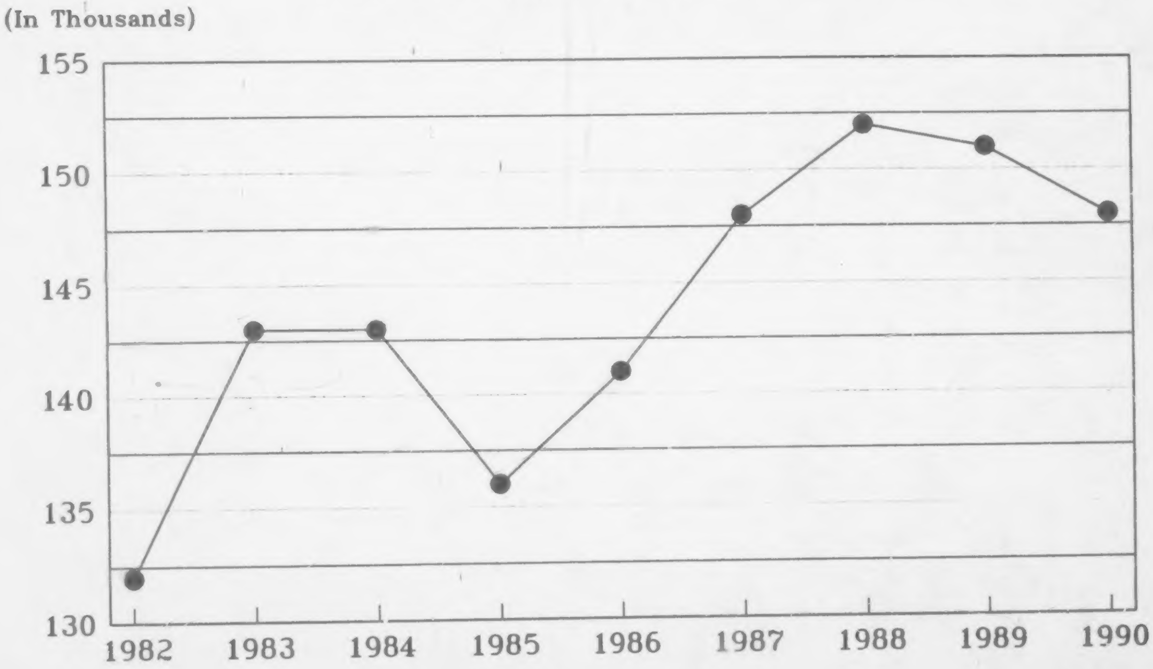
- Subsidized Canadian timber, by artificially depressing U.S. lumber industry revenues, hinders the ability of U.S. lumber companies to spend as much as they ideally would like for reforestation and conservation programs by forcing them to respond to short-term pressures.

- Encouraging the adoption of market-based systems values timber, a precious natural resource, fairly. Market rates for stumpage are rising as conservation concerns increase. In both the United States and Canada, logging is being restricted. Unfortunately, the recent increase in market value for timber has not been reflected in the stumpage rates set by the Canadian provincial governments.

Of course the MOU is a trade agreement, not an environmental agreement. But its adoption -- and the effort to offset in part the non-market Canadian timber subsidies -- has had the effect of promoting conservation and reforestation.

Chart 8

## TOTAL EMPLOYMENT: SAWMILLS AND PLANING MILLS, GENERAL



Source: U.S. Dept. of Commerce, ITA, U.S. Industrial Outlook

Chart 9

## VOLUME OF LUMBER PRODUCTION
(BILLION BOARD FEET)

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| CANADA | 10.8 | 12.3 | 13.4 | 15.0 | 13.0 | 10.9 | 14.9 | 17.2 | 18.4 | 18.6 | 18.3 | 16.6 | 15.9 | 20.3 | 20.6 | 22.3 | 22.0 | 25.9 | 25.3 | 24.1 | 15.7 |
| UNITED STATES | 27.4 | 29.7 | 30.9 | 31.3 | 27.2 | 25.7 | 29.7 | 31.8 | 31.9 | 31.4 | 26.2 | 24.7 | 23.8 | 29.7 | 31.2 | 30.6 | 35.3 | 38.2 | 38.1 | 37.5 | 25.4 |
| CANADIAN SHARE OF TOTAL N.A. LUMBER PRODUCTION | 28.3% | 29.3% | 30.3% | 32.4% | 32.3% | 29.8% | 33.4% | 36.5% | 35.1% | 37.2% | 41.1% | 40.2% | 40.1% | 39.8%[1] | 41.7% | 40.6% | 38.4% | 40.4% | 39.9% | 39.0% | 38.3%[2] |

Source: Western Wood Products Association Dominion Bureau of Statistics

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[1] Canadian share of lumber production dropped in 1986 because of lumber strike in British Columbia.

[2] Canadian share of lumber production in 1990 is the lowest it has been since 1979.

The Globe & Mail - Report on Business (Toronto, Ont.)
MAY 20 1989

# Are B.C.'s logs priced too low?

3 76

**BY CRAIG McINNES**
The Globe and Mail

VICTORIA

ALBERTA HAS oil and gas to fuel its economy. Saskatchewan has potash. In British Columbia, the most important natural resource is the province's renowned forests.

Recently, voices from labor, native Indian, industry and environmental groups across the province have been raised, demanding a public inquiry into the management of those forests. They charge that this most important publicly owned resource is not being managed in the public interest.

About 85 per cent of the province is owned by the Crown and managed by the Ministry of Forests, whose self-proclaimed mission is to manage the land "to provide maximum economic and social benefits to all British Columbians."

The critics argue that "social benefits" are being all but ignored, and that too large a share of the "economic benefits" is going to a decreasing number of multinational forestry companies.

Private companies are given rights to cut on publicly owned land through several tenure schemes. The system is designed to encourage capital investment in logging and wood product manufacturing by ensuring forest companies of a stable wood supply.

The tenure systems have evolved in response to four royal commissions into the practice of forestry in the province. The last of them, which reported in 1976, endorsed the basic system but called for some changes to deal with what commissioner Peter Pearse saw as a dangerous trend toward corporate concentration in the industry.

At the time the 10 largest companies controlled 85 per cent of the cutting rights on the coast, where the largest, most valuable trees grow. Since then, corporate mergers and interlocking ownerships have put most of the allowable cut in the hands of only five groups.

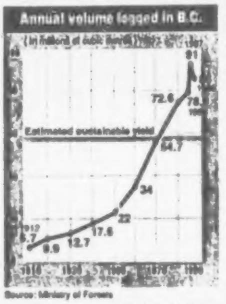
"The concentration I was concerned about . . . has gone on apace with a vengeance in the past 10 years," Dr. Pearse noted.

As a result, he says, competition for trees has been virtually eliminated and the price of logs is artificially low. And because the price does not reflect their true value, there is no pressure to get the maximum return from each log.

B.C. sawmills concentrate on turning logs into lumber and pulp as quickly as possible rather than getting the most product out of each log, the critics say.

"In the U.S. coastal mills the recovery of lumber is higher from the same species and grades than it is in B.C. mills," Dr. Pearse said. "It's not surprising that an American miller who is paying a hell of a lot more stumpage (a tax based on the value of the wood cut) is going to be more careful about what they get out of a load of logs."

Annual volume logged in B.C.



Source: Ministry of Forests

ROSE ZGODZINSKI/The Globe and Mail

The critics argue that for British Columbia this means less revenue from the resource and fewer jobs.

"It takes three times as much timber in B.C. to sustain a job as it does in Sweden," said Clay Perry of IWA Canada, the country's major loggers' union.

The U.S. industry provides 3.5 jobs for every thousand cubic metres of wood cut compared to about one job per thousand cubic metres in British Columbia, the critics say. The amount of wood cut in the province has almost doubled over the past two decades, to 90 million cubic metres from 50 million. But the work force has remained fairly constant.

That is the natural result of modernizing mills and introducing more efficient techniques in the woods, the industry argues.

"We have to become more efficient or we don't survive in the world markets," said Ken Williams, chief forester for MacMillan Bloedel Ltd. "You are constantly trying to improve your efficiency and lower your costs. Employment reduction is part of the process."

What the union wants, Mr. Perry said, is not a return to archaic production methods, but more value-added production in British Columbia — making moldings, for example, instead of just producing two-by-fours.

"Most important, we can employ an awful lot more people in the woods doing intensive silviculture" (tree farming).

Dr. Pearse argues that the tenure system is part of the reason for the corporate concentration in the industry. "The tenure system is biased towards large corporations," he said. Small firms often have a hard time getting access to wood, and they often must pay more for what they get.

The longest tenure arrangement and the one that puts the most control over Crown forests in the hands of private companies is the timber farm licence system.

TFLs, which are renewable, are essentially land grants that for 25 years give private companies the right to manage public forests. In return, the firms agree to ensure the forest is managed on a sustainable basis, and they pay stumpage on the trees they cut. TFLs are typically for large tracts of forest. Fletcher Challenge Ltd.'s TFL 46 on Vancouver Island, for example, covers 1,500 square kilometres.

Only a small percentage (15 per cent in 1988) of the cutting rights on Crown land are sold to small businesses through a competitive bidding process. (In the United States, almost all public timber allocated for harvesting is sold by competitive bid.)

Under other tenure systems, the Ministry of Forests manages the public land but awards the cutting rights for fixed periods to private companies that pay fixed stumpage fees.

But the ministry is considering turning a large chunk of land that is being harvested under these tenure systems over to private corporations to manage as TFLs.

During public hearings into the proposal earlier this year, critics called the plan a multi-billion-dollar giveaway to the industry giants.

The large forest companies argued that converting these lands to TFLs will provide the kind of stable wood supply they need for making long-term investments to provide jobs.

"When we clear away the self-interest of those who are opposing the policy, we believe that the public will understand that they have benefited immensely," Mr. Williams said in a written submission to the government.

The forests ministry is expected to make its decision on the conversion proposal later this summer.

## U.S.-CANADA SOFTWOOD LUMBER AGREEMENT: SECTION IV: CANADIAN EFFORTS TO AVOID THEIR OBLIGATIONS

**The MOU has been flawed by:**

- **Canadian attempts to skirt or evade the disciplines of the MOU; and**
- **Recent Canadian threats to abrogate the MOU -- with the likely return to uncontrolled subsidies and injury to the U.S. industry if the U.S. Government did not act.**

The Department of Commerce has done an excellent job monitoring compliance with the MOU. Perhaps the greatest evidence of the extent of DOC's efforts is Canadian irritation. An M.P. from British Columbia has launched a media campaign complaining that the U.S. Government has monitored closely the implementation of the agreement.

In its efforts to implement the agreement, however, the Department has been confronted by numerous Canadian efforts to skirt or subvert the agreement:

**A. Failure to Pay Full Export Tax or Equivalent:** Some Canadian firms have been caught red-handed, and various statistics suggest that evasion may still be wide-spread:

- In several provinces, collections continue to fall far short of the expected levels. See Chart 10.
- Larry Broderick, a U.S. distributor of Canadian lumber, was outraged by business lost to lumber smugglers who avoided the export tax and formed the Alliance for Enforcement of the Canadian Lumber Tax. He noted that his distributorship has "been beaten by other wholesalers consistently by such a substantial amount that it cannot be explained by the marketplace." In April 1989, Broderick presented evidence at a Congressional hearing that a Canadian lumber wholesaler hid taxable Ontario lumber in a shipment on non-taxable British Columbian lumber.

Another method for evading the export tax is to classify lumber exports as other wood products (e.g. fencing) not covered by the agreement, or to misclassify lumber as remanufactured products (which are subject to a different tax structure). Canadian exports of these products increased after the MOU was adopted, suggesting that Canadian companies misclassified shipments to avoid the tax. For example:

- In October 1990 Revenue Canada announced that several Canadian companies had not been paying the 15% tax as required by the MOU because they had misclassified lumber as remanufactured. The Globe and Mail, September 12, 1990.

- Fencing was exempted from the export tax. The value of imports classified as fencing rose from $42 million in 1986 to $54 million in 1987 and to $57 million in 1988, a jump of roughly 36% in two years.

- Specially remanufactured cut stock was exempted from the agreement. The volume of dimension cut stock exports for the first nine months of 1987 was 3.7 times the volume of such exports for all of 1986.

B. **Failure to Pay Full Stumpage:** There is evidence of systematic underreporting of stumpage in British Columbia as a method of evading the higher stumpage imposed as a replacement of the export tax:

- Several years ago the Royal Canadian Mounted Police's Log Theft Section observed in a letter that it had uncovered two incidents of suspected scale fraud "amount[ing] to $300,000 in unpaid stumpage, and they are by no means isolated incidents."

- One source estimates that losses to British Columbia from stumpage evasion at between $25 million and $100 million [$Can] annually. "A Growing Scaling Scandal," British Columbia Report, June 1989.

- The Victoria, B.C. Times Colonist reported in April 1989 that British Columbia's Auditor-General found a "high risk" of lost stumpage due to incorrect scaling and tardy or nonexistent reporting.

C. **Adequacy of Canadian Enforcement:** At times the U.S. lumber industry has raised concerns over the adequacy of enforcement measures:

- Revenue Canada has allowed some companies to use an inventory stystem to calculate the amount of lumber tax due rather than basing tax liability on the export tax notice as required in the MOU and the Canadian law and regulations. Apparently some of the audits are based on a daily "snap-shot of lumber inventory, which opens the door to manipulations of the inventory.

**D. Possible New Canadian Subsidies:** Paragraph 6 of the MOU prohibits the Canadian governments from taking any measure "which has the effect of offsetting or reducing the export tax or replacement measures." Several Canadian measures have been proposed or implemented that may have the effect of being new subsidies prohibited by the agreement:

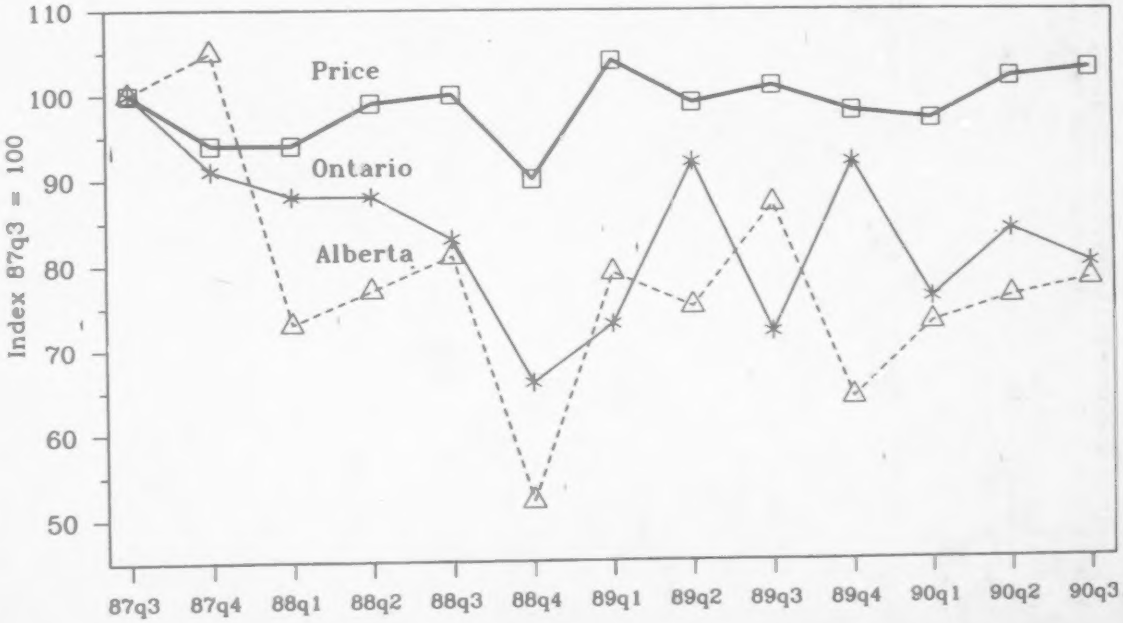
- British Columbia has permitted some firms to pay stumpage when it is processed, rather than when it is harvested. This delays stumpage payments for months. The value of this subsidy may be substantial, although not easily quantified.
- Other changes in administering B.C.'s timber price system either represent subsidies or confusion in the pricing system. Among these measures was a price freeze on chip values for 18 months.

**Conclusion:** The U.S. lumber industry is not asking the U.S. Government to retaliate for breaches past or present. It is asking for a continuation of strong enforcement measures because -- just as the MOU was needed to offset Canadian timber subsidies -- strong enforcement is necessary to keep the MOU viable. In addition, the U.S. industry notes that Canadian requests to renegotiate the MOU should be placed in the context of a history of non-compliance by some Canadian firms.

Chart 10

## SOFTWOOD LUMBER FROM CANADA:

Price vs. Per-Unit Collections



## U.S.-CANADA SOFTWOOD LUMBER AGREEMENT: SECTION V: CANADIAN ATTEMPTS TO RENEGOTIATE THE MOU

The greatest problem facing the MOU is **persistent Canadian industry attempts to withdraw from the MOU's disciplines**, efforts that have gained supporters at the highest levels of the Canadian Government:

- Minister of External Affairs Clark, Minister of Trade Crosbie, and Minister of Forests Oberle all have called for renegotiation of the MOU.

**Some Canadians, however, do not support elimination of the MOU:**

- The Maritime Provinces were not subject to the MOU because they operate their forest system primarily by a competitive bid system. The director of the Maritime Lumber Bureau was quoted in the October 30, 1990, The Times-Transcript (Moncton, New Brunswick) as fearing that the return of low stumpage in provinces such as British Columbia would unfairly advantage those provinces.

Underlying the calls for renegotiation is the desire of Canadian firms to receive once again a large stumpage subsidy.

**The MOU Must Continue to be Monitored and Enforced**

- The MOU works:
  - it resolved one of the most bitter trade disputes in U.S. history;
  - it generally has been fair to both industries.
- As a legal matter, the MOU was negotiated to last as long as government, and not the market, sets Canadian stumpage fees.
- As a practical matter, since many of the Canadian provinces have not agreed to sell their timber competitively or otherwise to end their subsidies, the same potential for large-scale and harmful subsidization exists if the MOU were eliminated as existed in 1986.
  - The Council of Forest Industries, B.C. Minister of Forests Richmond, and the President of IWA-Canada Local I-425 have all called for an end to the agreement. Richmond was quoted in a recent interview with Canadian Forest Industries as agreeing that increased stumpage rates implemented pursuant to the MOU have hurt the

Canadian industry. He vowed to take measures to eliminate the MOU.

## The Canadian Government Should Be Held to Its Bargain

The U.S. lumber industry did not get everything it wanted in negotiating the MOU, and neither did Canadian industry. **The deal is very fair to the Canadians in some respects and favorable to them in others:**

- The United States permitted Canada to avoid a 15% duty and collect the proceeds for itself, or to implement replacement measures, at provincial discretion.
- The MOU is only a partial subsidy offset. It did not require Canadian producers to institute a market system or even to peg stumpage to market rates. Thus, as is occurring now, market prices can exceed the stumpage prices even with the export tax included. As long as the Canadian provinces continue to provide administered, rather than market, timber pricing, Canadian non-market stumpage prices are likely to lag well behind the market prices paid by U.S. companies.

## U.S.-CANADA SOFTWOOD LUMBER AGREEMENT:
## SECTION VI: MYTHS AND FACTS

For the Canadians, the MOU has become a convenient scapegoat for the real and perceived ills of their lumber industry. Sober analysis, however, reveals that Canadian complaints miss the mark:

- Canadian industry has gone through some necessary readjustment as its level of subsidies dropped.

- Present market conditions are the chief cause of Canadian lumber woes, to the extent they exist.

**The major Canadian complaints about the agreement mainly stem from the Canadian industry's belief that it has the right to sell subsidized timber in the United States without any restrictions in an attempt to save Canadian jobs and profits.** This ignores international trade law and is unsupportable as trade policy.

**MYTH 1:** **The MOU is seriously hurting the Canadian lumber industry.**

**FACTS:** **(1) Levelling the playing field necessarily adjusts market shares toward competitive equilibrium.**

- It is certainly true that Canadian lumber firms' costs have risen since the MOU was negotiated -- that was the point of the agreement. Below-market stumpage conferred a subsidy. The MOU partially offset that subsidy.

  By forcing Canadian companies to pay an export tax, or a price for timber closer to its market value, the MOU did reduce the Canadian share of the U.S. market that had been bought by unfair subsidies. What the Canadians really are complaining about is having to face the fairer conditions of competition introduced under the MOU.

- U.S. companies captured almost the entire growth in the U.S. lumber market in the post-MOU period while Canadian shipments remained flat. This only partially reversed the trends of the decade from 1975 to 1985 (the decade of the most extensive provincial subsidies), when Canadian lumber capacity had increased 77% and U.S. lumber capacity only rose 6%.

It is actually U.S. industry that is still being hurt by Canadian practices:

- Because the MOU is only a partial subsidy offset, stumpage prices continue to confer an advantage to Canadian companies. Canadian stumpage prices again have fallen far below the market price.

- Recent cross-border comparisons, which admittedly are far cruder than the data presented for the 1986 countervailing duty case but still indicative of overall trends, suggest that stumpage in British Columbia, for example, continues to lag far behind comparable U.S. stumpage.

**(2) Canadian companies are not doing as poorly as they suggest.**

The Canadian industry complained that its lumber sector was dripping red ink -- even during times when overall forestry profits had reached record levels. These complaints are somewhat disingenuous:

- They ignore the value of residuals. Some of the analyses suggesting a loss of profitability in the Canadian lumber sector ignore the value of residuals produced during milling, such as chips or bark. In a U.S. mill, the value of these residuals far exceeds the margin of profit. Ignoring the residuals would, not surprisingly, suggest that a mill is running in the red when it is in fact performing profitably.

- They ignore the effects of transfer pricing. Even if the calculation correctly shows lumber mills to be operating on the margin, it may be inaccurate to conclude that the MOU is at fault. Canadian forest products industry profits had been at record levels in between the adoption of the MOU and the onset of the recession. Admittedly, the majority of the profits are attributed by accountants to pulp and paper production, but those profits are directly related to the low price of chips paid to lumber mills that are, in most cases, owned by the same companies that own the pulp and paper mills. In other words, the low profits reported for lumber mills may be attributed to transfer pricing and the oligopolistic structure of the Canadian forest products industry.

**(3) Canadians are making the MOU a scapegoat for unemploy ment and profitability problems engendered by other factors:**

- The recession. During the current recession, both U.S. and Canadian producers have suffered mill closings and loss of lumber production. This shared pain is a positive result of the agreement, since U.S. firms bore the brunt of the last recession in the face of Canadian stumpage subsidies. To the extent that Canadian forest products firms are suffering more than their counterparts elsewhere, the cause is the high Canadian dollar and higher Canadian wage increases, according to an executive at MacMillan Bloedel Ltd. "Canadian Forest Firms Claimed Suffering Most: Strong Dollar, Wages Blamed by MB Official," *Vancouver Sun* (January 24, 1991).

- Automation. As the chief forester for Macmillan Bloedel Ltd. noted, "You are constantly trying to improve your efficiency and lower your costs. Employment reduction is part of that process." Quoted in "Are B.C.'s Logs Priced Too Low?" *The Globe and Mail*, May 20, 1989.

- Lack of raw material. Overlogging in British Columbia, for example (itself partially the result of low stumpage fees), has produced declines in both the quality and quantity of the fiber supply, according to Leslie Reed, a professor of forest policy research at the University of B.C. Production cuts in several mills resulted from shrinkage in Allowable Annual Cut. "Fear in the Forests," *British Columbia Report*, October 8, 1990.

**MYTH 2: The system for calculating Canadian stumpage or fees under the MOU does not take into account shifts in market prices for lumber.**

**FACT: This is inaccurate. The export tax and replacement measures do adjust up and down based on lumber prices.**

The MOU is a 15% tax on lumber exports. For provinces that have not adopted replacement measures, the tax is assessed based on the value of the lumber exported. As the price of the lumber exported decreases, the amount of tax decreases.

Replacement measures, too, adjust for changes in the market. In British Columbia, for example, the provincial government replaced the export tax with a system of increased stumpage rates, but that system has a provision to increase or decrease target stumpage based on market conditions. In fact, the adjustment mechanism used was proposed by the Canadian Government.

The easiest way for the Canadian governments to solve their stumpage subsidy problems would be to institute a competitive market in the sale of timber, as suggested by various advisory reports to the Provinces of British Columbian and Ontario. In the Maritime Provinces this is already done to a large extent.

**MYTH 3:** **The MOU is no longer necessary because of changes in exchange rates.**

**FACTS:** **Canadian subsidies have not been eliminated so the MOU is still necessary. Exchange rate shifts are irrelevant.**

This argument is the same argument the Canadian lumber industry made unsuccessfully in 1986. The Canadian industry argued that large shifts in nominal exchange rates -- not enormous timber subsidies -- resulted in the flood of Canadian lumber imports. They were wrong then and they are wrong now:

(1) The ITC concluded in 1985 that, despite the marked change in the nominal value of the dollar in the early 1980s, the real exchange rate shift between the United States and Canada was relatively small.

(2) The effect of exchange rate changes on the price competitiveness of Canadian lumber is an issue completely unrelated to the granting of subsidies to the Canadian lumber industry. Fluctuations in exchange rates result from macroeconomic conditions and do not either increase or decrease the benefit of the subsidy granted. A shift in the exchange rate will affect the price competitiveness of Canadian exports expressed in U.S. dollars, but this is true for all tradeable goods, not just with respect to lumber exports.

(3) It is true that the strength of the Canadian dollar is putting pressure on Canadian exporters. Complaints about exchange rates, however, are macroeconomic problems and more appropriately addressed in other fora, e.g. the G-7 process or with the Canadian Finance ministry. In fact, if every sectoral trade agreement set off exchange rate shifts, it would tend to undermine multilateral exchange rate agreements.

**MYTH 4: The MOU infringes Canadian sovereignty.**

**FACTS: The MOU in no way affects Canadian sovereignty; it only restricts Canada's ability to export subsidized lumber to the United States.**

(1) The United States acted within its legal rights to countervail subsidized exports. Every government has the right to price its resources as it pleases. When subsidized goods enter the territory of another country, however, it is that country's sovereign right, recognized by international agreements, to countervail. Thus, there is no "right" to export subsidized lumber to other countries.

Setting stumpage fees below the market rate constitutes a subsidy. A simple example illustrates the point. Assume that a government-owned gold mine can produce gold for $10/ounce. If the government sold the gold at $15/ounce when its market value was $400/ounce, a subsidy would exist. (The same would be true if the U.S. Government sold one dollar bills for ten cents: above their cost of production, but much lower than their value.)

(2) The provisions of the MOU do not unilaterally infringe Canadian sovereignty. Canada elected to negotiate the MOU instead of paying the countervailing duty imposed by the United States under its own sovereign rights.

Canada is welcome to export to the United States under market principles:

- Until Canada adopts a competitive timber market, however, U.S. monitoring is necessary under the agreement to assure compliance.

- U.S. monitoring under the MOU is similar to that which occurs under many international agreements and should be unexceptional.

Substitute replacement measures under the MOU require more intensive U.S. monitoring of their effectiveness and adequacy than does the export tax system. But the choice on reforming stumpage subsidies or just paying the export tax is left to the provinces.

**MYTH 5:** **Cross-border stumpage comparisons neglect the differences in conditions (type of lumber, rainfall, etc.) that make Canadian prices seem too low.**

**FACTS:** **The Coalition's analysis takes into account precisely these factors.**

Sophisticated cross-border comparisons found U.S. lumber companies paid up to ten times in stumpage what Canadian companies paid. To verify this result, the Western States Legislative Forestry Task Force in 1985 sponsored a comparison of the B.C. and U.S. appraisal systems at Hayden Lake in Idaho. Under that comparison, U.S. and B.C. officials appraised the same stand of timber (chosen by the B.C. appraiser from a recent B.C. sale. The B.C. appraisal system resulted in a sales price of $4.35/Million Board Feet (MBF) while the minimum bid U.S. bid price was set at $14.35/MBF, i.e. the differences in the application of the U.S. and Canadian residual value appraisal systems resulted in a difference of almost $10.00/MBF.

Under the old B.C. system, the price paid by the Canadian lumber systems would have been $4.35. Under the U.S. system, the appraisal only sets a minimum bid. Competitive U.S. bidding was estimated to raise the U.S. price to $41.00/MBF. The result: U.S. firms were paying an estimated ten times for an identical stand of timber.

## U.S.-CANADA SOFTWOOD LUMBER AGREEMENT:
## SECTION VII: THE FUTURE OF THE MOU

The MOU works and is a necessary mechanism by which to offset Canadian timber subsidies. The U.S. Government must firmly resist Canadian entreaties to eliminate the MOU and instead step up its monitoring efforts of Canadian compliance with the MOU:

### ROLE OF THE U.S. EXECUTIVE BRANCH

The Executive must move ahead on three fronts to maintain an effective MOU:

- **It must continue to monitor Canadian compliance with the agreement.** This includes both outright evasions of the export tax and also the adequacy of replacement measures.
- **The United States must resist continuing Canadian efforts to eliminate the MOU.**
  - As Canadian stumpage rates continue to lag far behind market rates, it is hardly the appropriate time for the Canadians to voice bitter complaints to the United States about the MOU.
  - In the event of Canadian non-compliance with the MOU, the Administration should invoke Section 301 of the 1974 Trade Act pursuant to President Reagan's Executive Order.
- The U.S. Government should ensure that the Uruguay Round GATT negotiations do not undercut the MOU, either by:
  - removing the ability of the U.S. Government to use Section 301 to enforce trade agreements; or
  - adopting a Subsidies Code that would sanction injurious natural resource subsidies -- permitting many nations to subsidize with impunity -- and could be used by Canada in efforts to undermine the MOU.

### ROLE OF CONGRESS

Congress can play a key role in maintaining a strong MOU:

- **Oversight.** Congressional hearings and interest in the MOU perform a valuable function in keeping the implementation and enforcement of the MOU a matter of public knowledge and attention:

- remind both the Canadian lumber industry and the U.S. Administration that the MOU remains a high priority for U.S. trade policy; and
- provide an open public forum for debate and dissemination of knowledge about the MOU.

- **Trade Law.** Congress should continue to maintain U.S. trade laws with teeth. Specifically, Congress should:
  - urge the Executive to reject any GATT agreement that removes the ability of the U.S. Government to use Section 301 to remedy violations of trade agreements;
  - urge the Executive to reject a GATT Subsidies Code that would permit natural resource subsidies;
  - pass the Trade Agreements Compliance Act (TACA) that would permit U.S. companies to request a U.S. Government review of compliance with existing agreements such as the MOU.

## CONCLUSION

**The MOU has been a great success for U.S. trade policy:**

- It was necessary to offset injurious subsidies.
- It has been instrumental in reducing penetration of the U.S. lumber market by subsidized Canadian lumber. As a result, U.S. production and employment have increased.

The success of the MOU, however, can only be maintained as long as the MOU is strictly enforced. The next few years should see:

- a redoubling of U.S. monitoring efforts;
- a strong commitment by both the U.S. Congress and the Administration to keep Canada from renegotiating the MOU or walking away from its obligations.

# HEARING ON 1986 U.S.-CANADIAN MOU ON SOFTWOOD LUMBER BEFORE THE SUBCOMMITTEE ON REGULATION, BUSINESS OPPORTUNITIES, AND ENERGY OF THE HOUSE COMMITTEE ON SMALL BUSINESS

Statement by M. J. "Gus" Kuehne, President
Northwest Independent Forest Manufacturers
P. O. Box 11346
Tacoma, Washington 98411

2322 Rayburn House Office Building
Washington, D.C.

February 22, 1991

MR. CHAIRMAN AND SUBCOMMITTEE MEMBERS: I am Gus Kuehne, President of Northwest Independent Forest Manufacturers. NIFM is an association of 50 companies which harvest timber, manufacture lumber, plywood, veneer, shakes, shingles, and wood chips. NIFM members are primarily small businesses located in Western Washington who are dependent upon public timber for their raw material supply. Most of our members sell wood products in the local market, the U.S. domestic market, and throughout the world.

Even though NIFM is a relatively small association, we have been in the forefront of most issues affecting U.S. wood products trade. We were the first organization to call for a 332 study of Canadian lumber imports and helped to organize the domestic industry in filing a countervailing duty on Canadian lumber in 1983 and in 1985. NIFM filed a 201 action on behalf of shake & shingle manufacturers in 1985. We were the first association to call for a Commerce study of Japanese trade practices which resulted in the Bush Administration identifying forest products in a Super 301 filed against Japan last year. In July of 1989 we filed a short supply petition on behalf of the majority of lumber and plywood manufacturers in Oregon and Washington. We were also deeply involved in the passage of H.R. 1594, sections of which restricted the export of logs from public lands in the West. I serve as a member of the industry sector advisory committee for trade policy matters on lumber and wood products (ISAC - 10) for the U.S. Trade Representative and Secretary of Commerce. NIFM is a charter member of the U.S. Coalition for Fair Lumber Imports.

I believe that I have testified at more hearings on Canadian wood product imports in the past decade than anyone in the country, beginning with testimony before the Senate Government Affairs Committee in November of 1981. I bring this to your attention not to extol the virtues of my testimony but to indicate the depth of our concern for wood products trade with Canada and our commitment to assure that it is as free and fair as possible.

In my testimony I will cover three major areas. First, the importation of Canadian lumber into the U.S. market. Secondly, the changes in timber prices as a result of the 1987 stumpage price agreement with British Columbia. Lastly, the state of the industry in the Northwest. After presenting this information, I will then attempt to answer the questions Chairman Wyden posed in a letter inviting me to testify dated February 10, 1991.

Importation of Canadian Softwood Lumber

From the mid-1970's through 1985, Canadian lumber imports commanded a steadily increasing share of the total softwood lumber consumed in the United States. In 1975, Canadian imports represented only 18.7% of U.S. softwood lumber consumption, increasing to 33.2% in 1985, see Table I attached. Canadian imports increased in market share in strong and poor markets alike during this period, primarily at the expense of U.S. mills in the West. U.S. western mill share of U.S. domestic softwood lumber consumption declined throughout this period from 57.8% in 1975 to a low of 42.6% in 1985. Southern U.S. mill consumption on the other hand, remained relatively stable through the period, though increasing somewhat in the early 1980's and declining in 1985.

For a number of factors 1986 was rather a confused year, there was a major strike in the industry and a preliminary duty on Canadian imports imposed in October of 1986. At the end of December, one hour before the deadline, a Memorandum of Understanding on softwood lumber was signed between the U.S. and Canadian governments which resolved the softwood lumber dispute prior to the imposition of a final duty. This agreement provided for the Canadian government to impose a 15% surcharge on all lumber exported to the United States. For this, the U.S. government agreed to drop the preliminary duty of 15% and not impose a final duty determination as was scheduled in February of 1987. Also, the U.S. industry, in a side letter, agreed to withdraw its case and President Reagan signed a letter agreeing to have the Secretary of Commerce impose a duty should the Canadians violate the MOU.

Throughout the first three-quarters of 1987, the government of Canada imposed a surcharge on all Canadian lumber imported into the United States of 15%. Beginning in the 4th Quarter of 1987, British Columbia signed a separate agreement agreeing to increase stumpage prices to fully offset the dollar value of the 15% surcharge.

One can see on the chart in Table I that Canadian lumber imports declined significantly since 1985, dropping primarily in the first two years, to just 29% in 1987 and declining only modestly since that point. The increase in U.S. market share during this post-MOU period has been felt mainly by western mills which regained a portion of the market share they had lost in the previous decade. In 1990, however, the picture changed slightly; a decline in sales of national forest timber, particularly in the Pacific Northwest, has resulted in southern mills gaining about 2% of total U.S. market share.

Chart A shows the increasing Canadian penetration of the U.S. softwood lumber market from 1980 through 1985 and then a decline from that point. The statistics in this chart are taken from a different source than those in Table I and differ only very slightly.

In addition to looking at market share of U.S. lumber consumption, I think it is also important to look at lumber production in U.S. and Canadian mills to determine what effect the MOU has had upon the industry. Table 2 shows U.S. and Canadian softwood lumber production from 1978 through the first ten months of 1990. You will see that U.S. production is divided between the South & Other, while Canada is shown as British Columbia & Other. From this prospective, changes in the industry are not as dramatic as simply looking at U.S. softwood lumber consumption. When one looks at the share of production enjoyed by these various regions of North America, one sees that the South has gained much more modestly and the western and other U.S. regions declined more moderately, while as British Columbia has remained much more stable and other Canadian regions have increased only modestly. Looking at British Columbia, one must assume that as British Columbia market share has remained rather stable at between 24% to 25% of total North American production, this must mean that B.C. is exporting a higher percentage of its lumber production to make up for its decline in U.S. market share.

### Timber Prices - Northwest vs. British Columbia

The second issue I will discuss is the comparison of the price of standing timber harvested from Forest Service lands in Region 6 with the price of Provincial timber sold in British Columbia. This comparison is further divided between the westside of Region 6 with Coastal British Columbia and the eastside of Region 6 with the Interior of British Columbia, see Table 3 attached. In order to assure comparing apples with apples, all stumpage prices have been converted to 1) Canadian fiscal years, since some Canadian years were not available by quarter, 2) converted to U.S. dollars and 3) scribner scale. As previously stated, stumpage price increases in British Columbia were required, as a result of the stumpage price agreement reached, that eliminated the 15% surcharge on lumber exported to the United States after October of 1987.

Obviously from the Table 1 can see that stumpage price increases in Coastal British Columbia occurred throughout most of Canadian fiscal year (CFY)1988. Cross-border comparisons made in determining the preliminary duty imposed in October 1986 were based upon timber prices paid primarily in 1985, which is the majority of fiscal year 1986.

In other words for purposes here, I believe we can assume that fiscal year 1986 comparisons in stumpage prices are the basis from which the 15% preliminary duty, 15% Canadian surcharge, and B.C. stumpage price increase agreement was determined. At that time, stumpage harvested from the westside of Region 6 sold for $130 per thousand board feet, while coastal B.C. prices were only $18 per thousand, or a difference of $112 per thousand board feet. With stumpage price increases which went into effect in (CFY)1988, British Columbia stumpage increased to $40 per thousand board feet and westside Region 6 decreased to $124/MBF, resulting an $84 difference. With the increasing competition for timber sold on the westside of Region 6 in (CFY)1989, 1990 and the first quarter of 1991, stumpage prices have escalated considerably on westside of Region 6, where there has been virtually no increase in stumpage prices in coastal British Columbia. Thus, stumpage price differences as shown here in the last two and one-quarter years are greater than they were prior to the imposition of the stumpage price increases in coastal British Columbia. I would remind the committee that these numbers are in Canadian fiscal years, so the first quarter of 1991 is actually April 1 through June 30 of 1990. Since June of 1990 we do not have information on British Columbia timber prices, but I can assure you that the price of timber harvested from the westside of Region 6 has escalated even further.

Looking at a comparison of the eastside of Region 6 with the interior of British Columbia, one can see the same sort of story, only in this case eastside Region 6 prices do not show quite as dramatic a price increase compared with the interior of B.C. However, timber price differences are still greater than before the B.C. stumpage agreement.

The prices shown in Table 3 take into account the differences in exchange rate for the various quarters timber was harvested as reported by the International Monetary Fund in their international finance statistics. They also taking into account differences in measuring timber using conversion factors from cubic meters, B.C. firm wood scale to U.S. scribner scale as recommended by the Forest Service-Pacific Northwest Experiment Station.

## State of the Northwest Forest Industry

Finally, I would like to describe for you the state of the forest products industry in the Pacific Northwest. In researching how to describe the critical condition of the industry, I found it impossible to improve upon the statement by Paul F. Ehinger & Associates in their publication dated January 1, 1991, reporting on the forest products industry in "Report on Mill Closures, Operations, and Other Related Information." In their summary they state:

The last half of 1990 has found the forest products industry in the Pacific Northwest reeling from a one, two punch that leaves communities, mills and employees in a state of shock.

The combined effects of the deteriorating timber supply and slumping market has forced the closure of mills, with loss of employment and permanent damage to small timber dependent communities.

The updating of the information on mill closures has been complicated the last few months by the rapid changes in the woods, mills and marketplace.

We have a situation that was originally driven by a timber supply shortage only to be aggravated by a rapid decline in the forest products markets. Today's list of closures and curtailments reflect both situations with the depressed market driving the present action. Some of the closure actions are motivated by the desire not to dissipate a limited timber supply on a market that can yield only further losses to the mill.

Once the market returns to more normal conditions, which could be as soon as mid year 1991 but more likely not until 1992. the industry and marketplace will feel the full effects of the timber shortage. In the West, we are in a "Catch 22" situation for the next several years.

Oregon is hardest hit by the shock waves because it is both the largest producing state for lumber and plywood in the U.S. and in addition its mills have the greatest dependency on federal timber of any major wood products producing state -- 60% of the raw material for lumber and plywood production comes from federal timberlands, i.e., U.S. Forest Service and Bureau of Land Management.

The pressures from the high-priced timber and depressed product markets are creating financial stress on numerous companies. This is showing up in the form of bankruptcies, creditor meetings and generally slow pay in response to normal financial obligations. In some cases there is major restructuring of a company's debt burden.

The markets may well have hit the bottom, but the critical situation will be how long do we remain at the bottom of the market with the burden of unprofitable timber as the only source of raw material for many Western mills. The timber sale programs of the public agencies are in complete disarray, and substituting of currently valued timber to use in current operations is only a mirage on a distant horizon of hope.

In the crisis of the early 1980's, this option was available to the mills because of an orderly timber sale program, and along with a much larger volume of timber under contract that offered them some degree of flexibility in the limited markets available.

The closures in Washington have been much less inasmuch as the structure of the industry is significantly different as shown by our graph on page 7--4. There is also a much smaller dependency on federal timber in Washington than in either Oregon or Idaho.

The Idaho closures are less because the impacts of the timber shortage are not as severe in Idaho and the ability to purchase more favorably prices timber has been better than in Western Oregon or Western Washington.

Following is the 1990 Summary of Mill Closures for Oregon, Washington and Idaho.

1990

MILL CLOSURE SUMMARY

| | Sawmills | | Plywood/Veneer | | Total All Mills | |
|---|---|---|---|---|---|---|
| | No. Mills | No. Employees | No. Mills | No. Employees | No. Mills | No. Employees |
| Oregon | 11 | 690 | 28 | 2,824 | 39 | 3,514 |
| Wash. | 8 | 463 | 4 | 145 | 12 | 608 |
| Idaho | 2 | 205 | 0 | 0 | 2 | 205 |
| TOTAL | 21 | 1,358 | 32 | 2,969 | 53 | 4,327 |

There have been a number of closures and curtailments in California, Montana, Arizona and in the Rocky Mountain States. These closures are less than in the Pacific Northwest, both in terms of lost production capacity and in loss of employment.

The impact of the Spotted Owl protection plan centers most heavily on the federal lands in Western Oregon. In Western Washington the percent of impact is heavier than in Oregon, but the level of dependency by Washington mills on federal timber is much less, thus the loss of production and employment to date has been significantly less.

The Eastern sections of both states as well as the state of Idaho have not had the major impact of the spotted owl, and as a result the overall pressures on the timber supply have not been as severe.

In Oregon and Washington, the other shoe that is yet to drop and be measured is the effect that the Spotted Owl protection plan will have on Private and State land. The pressures are severe in

> Washington and less so in Oregon. This is a function of the different environmental politics in each State. These pressures on State and Private land will surely reduce the availability of timber from these sources.
>
> Canadian producers (British Columbia most specifically) of all types of forest products -- lumber, plywood, OSB, waferboard, etc. -- are being impacted by the current decline in prices. They, like the producers in the Pacific Northwest Region of the U.S., have become the high-cost producers in a less than robust wood products market. They are closing mills and curtailing production. These problems stem from their geographic distance from markets, additional stumpage costs, and the exchange rate that keeps moving the Canadian dollar closer to parity with the U.S. dollar. Currently, industry has curtailed its employment levels by 20%, with the heaviest impact on the coastal B.C. mills and somewhat less in the interior.

I highly concur with Paul F. Ehinger & Associates remarks and would only add in this regard that as bad as conditions are currently, they would be much worse if the U.S.-Canadian MOU did not exist and Canada could insulate itself from the current recession by simply reducing stumpage rates to virtually zero, thereby allowing them to operate at hear capacity, while U.S. mills suffer the market decline unilaterally.

Questions of Chairman Wyden

I will now try to expound to the questions you ask in the invitation for my testimony:

- To what extent has the implementation of the Agreement affected pricing of Canadian timber products in the United States?

  The major impact of the MOU has been to effect pricing during this recessionary period, which the timber industry entered about one year ago. In this period, the MOU has kept the Canadians from driving down prices further than they already have retreated. In the strong market periods of 1986 through 1989, the MOU has had little influence on lumber prices.

- How has this impact on pricing affected the overall importation of Canadian timber products into the United States?

Table 2 clearly shows that from 1986 through 1989 B.C. lumber flowed into the United States at near record levels. While B.C. did suffer some loss of market share, the market in the United States was extremely strong and it is questionable if during that period Canada could have exported significantly more lumber than it did into the U.S. market.

- How have changes, if any, in Canadian importation effected domestic sales of U.S. timber products, the strength of the U.S. timber products companies and employment in U.S. timber manufacturing?

As previously stated, the primary change is in the current recession. If it were not for the MOU, U.S. timber product companies would have sold much less lumber in 1990 and suffered much higher monetary losses as a result of lower lumber prices and greater Canadian imports. This would have resulted in further mill closures and curtailments.

- In particular, how has this agreement impacted mills and companies in your area? Can you provide any anecdotal information regarding this point - companies which have opened new plants, or expanded existing facilities due to the MOU? What would be the impact of a unilateral Canadian abrogation of this agreement - would plants be closed and would employees be laid off?

The agreement has affected mills in the Northwest by allowing strong and weak market in the U.S. to be shared between U.S. and Canadian producers. In our area, this has meant a sharing of the Pacific Coast market with B.C. mills and to some extent a sharing of the overseas market. I don't believe that any new mills or plants have opened due to the MOU. I is more a case of fewer mills will have closed during the current recession. I trust that a unilateral abrogation of this agreement would result in President Bush living up to the promise made by President Reagan that abrogation of the MOU would result in a duty placed on Canadian lumber imports. If that isn't the case, I see no reason why Canada would not have already abrogated this agreement. In the unlikely situation that President Bush would not act in this manner, I expect that from 1 to 2 billion feet more Canadian lumber would be coming into the United States, if Canada broke the agreement and the Bush Administration did not respond. I would also expect in that unlikely circumstance, the U.S. industry would immediately file a countervailing duty case and this time ask for a permanent duty to be put in place, which of course, could not be abrogated by the Canadians.

- Is the United States Government satisfied that Canadian Provinces has executed the mandates of the MOU in good faith, do U.S. manufacturers believe the mandate has been

**carried out in good faith?**

I will leave the response to that question to Mr. Howlett, Chairman of our coalition. I would just say that I am constantly notified by friends in Canada of attempts by the forest industry in British Columbia to seek the elimination of the MOU and find other means to limit its effectiveness.

- If export charges have mitigated the effect of Canadian stumpage subsidization in some cases, how much further mitigation is needed - over what period of time - in order to establish Canadian stumpage at fair market levels, overall?

  Speaking for Northwest Independent Forest Manufacturers, I believe that a new cross-border comparison should be made and the results of that translated into stumpage price increases in British Columbia. I believe such cross-border comparisons would result in at least a doubling of stumpage prices in coastal British Columbia and an increase of about 25% in the interior.

Thank you for this opportunity to testify. I would be glad to answer any other questions you may have.

## TABLE I

### SOURCE OF U.S. SOFTWOOD LUMBER 1/ CONSUMPTION, 1975 - 10 MOS. 1990
(in million board feet)

| Year | U.S. MILLS |  |  |  | IMPORTS |  |  |  | TOTAL |  |
|---|---|---|---|---|---|---|---|---|---|---|
|  | Southern |  | 2/West & Other |  | Canadian |  | Other |  | Consumption |  |
|  | Volume | % | Volume | % | Volume | % | Volume | % | Volume | % |
| 1975 | 7,074 | 23.3 | 17,522 | 57.8 | 5,666 | 18.7 | 45 | 0.1 | 30,307 | 100. |
| 1976 | 7,641 | 21.3 | 20,317 | 56.6 | 7,906 | 22.0 | 45 | 0.1 | 35,909 | 100. |
| 1977 | 8,744 | 21.4 | 21,655 | 53.1 | 10,344 | 25.4 | 42 | 0.1 | 40,785 | 100. |
| 1978 | 9,096 | 21.3 | 21,670 | 50.9 | 11,764 | 27.6 | 77 | 0.2 | 42,607 | 100. |
| 1979 | 9,060 | 22.3 | 20,429 | 50.3 | 11,068 | 27.3 | 50 | 0.1 | 40,607 | 100. |
| 1980 | 7,757 | 22.9 | 16,535 | 48.9 | 9,514 | 28.1 | 25 | 0.1 | 33,831 | 100. |
| 1981 | 8,177 | 25.5 | 14,683 | 45.8 | 9,182 | 28.6 | 23 | 0.1 | 32,065 | 100. |
| 1982 | 8,232 | 26.4 | 13,822 | 44.3 | 9,091 | 29.2 | 28 | 0.1 | 31,173 | 100. |
| 1983 | 10,233 | 25.7 | 17,532 | 44.1 | 11,948 | 30.1 | 29 | 0.1 | 39,742 | 100. |
| 1984 | 10,430 | 24.4 | 19,059 | 44.6 | 13,221 | 30.9 | 49 | 0.1 | 42,759 | 100. |
| 1985 | 10,443 | 23.9 | 18,615 | 42.6 | 14,510 | 33.2 | 98 | 0.2 | 43,666 | 100. |
| 1986 | 11,499 | 24.4 | 21,473 | 45.6 | 13,960 | 29.7 | 137 | 0.3 | 47,069 | 100. |
| 1987 | 12,168 | 24.2 | 23,454 | 46.6 | 14,564 | 29.0 | 113 | 0.2 | 50,299 | 100. |
| 1988 | 12,061 | 25.5 | 21,474 | 45.4 | 13,700 | 28.9 | 106 | 0.2 | 47,341 | 100. |
| 1989 | 12,125 | 25.3 | 22,107 | 46.2 | 13,526 | 28.2 | 112 | 0.2 | 47,870 | 100. |
| 10 mos. 1990 | 10,601 | 27.2 | 17,862 | 45.8 | 10,459 | 26.8 | 53 | 0.1 | 38,975 | 100. |

Source: Western Wood Products Association
National Forest Products Association

Prepared by: Northwest Independent Forest Manufacturers

1/ U.S. consumption is computed by subtracting exports from shipments and adding imports. Southern pine exports are subtracted from Southern shipments, all other species exports are subtracted from West and other shipments.

2/ "Other" lumber accounts for about 5% of "West & Other"

2/11/91

## TABLE 2

## U.S. AND CANADIAN SOFTWOOD LUMBER PRODUCTION, 1978 - 10 MOS. 1990
(in million board feet)

| | United States | | | | Canada | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| Year | South Volume | % | West & Other Volume | % | British Col. Volume | % | Other Can. Volume | % | Volume | % |
| 1978 | 9,231 | 18.3 | 22,826 | 45.3 | 12,545 | 24.9 | 5,817 | 11.5 | 50,419 | 100.0 |
| 1979 | 9,283 | 18.6 | 22,149 | 44.3 | 12,517 | 25.0 | 6,038 | 12.1 | 49,987 | 100.0 |
| 1980 | 8,217 | 18.5 | 18,029 | 40.6 | 11,979 | 27.0 | 6,200 | 13.9 | 44,425 | 100.0 |
| 1981 | 8,415 | 20.5 | 16,261 | 39.6 | 10,424 | 25.3 | 5,983 | 14.6 | 41,083 | 100.0 |
| 1982 | 8,754 | 22.4 | 15,033 | 38.5 | 9,944 | 25.4 | 5,345 | 13.7 | 39,076 | 100.0 |
| 1983 | 10,181 | 20.5 | 19,545 | 39.3 | 13,043 | 26.2 | 6,943 | 14.0 | 49,712 | 100.0 |
| 1984 | 10,674 | 20.6 | 20,500 | 39.6 | 13,078 | 25.3 | 7,511 | 14.5 | 51,763 | 100.0 |
| 1985 | 10,730 | 20.0 | 20,591 | 38.4 | 14,004 | 26.1 | 8,252 | 15.4 | 53,577 | 100.0 |
| 1986 | 11,678 | 20.4 | 23,595 | 41.2 | 13,335 | 23.3 | 8,621 | 15.1 | 57,229 | 100.0 |
| 1987 | 12,473 | 19.5 | 25,762 | 40.2 | 15,888 | 24.8 | 9,983 | 15.6 | 64,106 | 100.0 |
| 1988 | 12,676 | 20.0 | 25,454 | 40.2 | 15,572 | 24.6 | 9,695 | 15.3 | 63,397 | 100.0 |
| 1989 | 12,544 | 20.4 | 25,001 | 40.6 | 15,234 | 24.7 | 8,841 | 14.3 | 61,620 | 100.0 |
| 10 mos 1990 | 11,646 | 23.0 | 19,533 | 38.6 | 12,131 | 24.0 | 7,288 | 14.4 | 50,598 | 100.0 |

Source: Western Wood Products Association
Dominion Bureau of Statistics

Prepared by: Northwest Independent Forest Manufacturers 2/11/91

## TABLE 3

## COMPARISON OF TIMBER HARVEST PRICES

Between Westside R-6 Forest Service with
Coastal British Columbia & Eastside R-6
Forest Service with Interior British Columbia
1/ Fiscal years 1986 - 90 & 1st Quarter 1991

| Fiscal Year | Westside R-6 $US/MBF | 2/ Coastal B.C. $US/MBF | Difference in Price $US/MBF | Difference since FY86 $US/MBF |
|---|---|---|---|---|
| 1986 | 130 | 18 | 112 | - |
| 1987 | 105 | 25 | 80 | -32 |
| 1988 | 124 | 40 | 84 | -28 |
| 1989 | 174 | 40 | 134 | +22 |
| 1990 | 198 | 44 | 154 | +42 |
| 1st Qtr. 1991 | 254 | 46 | 208 | +96 |

| Fiscal Year | Eastside R-6 $US/MBF | 2/ Interior B.C. $US/MBF | Difference in Price $US/MBF | Difference since FY86 $US/MBF |
|---|---|---|---|---|
| 1986 | 80 | 6 | 72 | - |
| 1987 | 95 | 7 | 88 | +16 |
| 1988 | 111 | 19 | 92 | +20 |
| 1989 | 125 | 34 | 91 | +19 |
| 1990 | 132 | 38 | 94 | +22 |
| 1st Qtr. 1991 | 126 | 41 | 85 | +13 |

1/ All prices converted to B.C. fiscal year from April 1 thru March 31st, i.e., fiscal year 1986 is April 1, 1985 thru March 31, 1986 & 1st Qtr. 1991 is April 1 thru June 30, 1990.

2/ B.C. timber converted from M3 B.C. scale to MBF scribner scale using 5.5 M3/MBF for Coast and 6.1 for Interior. Canadian $ converted to US$ by using average conversion factor for each quarter in B.C. fiscal year.

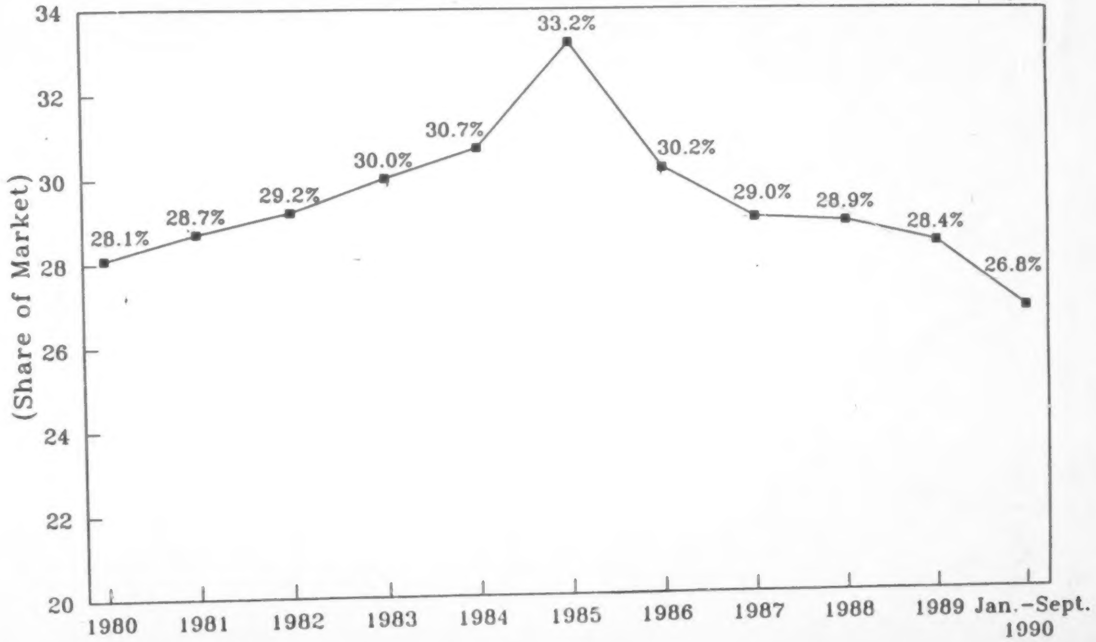
Source: USDA Forest Service - Production, Prices, Employment & Trade in NW Forest Industries, 1986-2nd Qtr. 1990: R-6 Prices, B.C. Prices FY86-88, and scale conversion factors.

U.S. Dept. of Commerce - Import Administration Office of Compliance: B.C. prices FY89-1st Qtr. 1991.

IMF, International Financial Stats: Exchange rates.

CHART A

## CANADIAN PENETRATION OF U.S. SOFTWOOD LUMBER MARKET



Source: NFPA Statistical Roundup

# Volumes logged and revenue benefits, U.S. National Forests versus B. C. public lands, 1988/1989

| | Volume Logged (million cubic metres) | Total Revenue from timber sales (per cubic metre) | Timber Revenues Paid Directly to County/ Municipal Governments (per cubic metre) | Net Revenues from National Forest and B.C. timber sales (per cubic metre) |
|---|---|---|---|---|
| **Tongass, Alaska NF** | 1.9 | $12.79 | $3.02 | $3.77 |
| **Prince Rupert Region BC** | 15.7 | $4.12 | none | ($1.55) |
| **Olympic NF** | 0.8 | $39.71 | $10.54 | $18.35 |
| **Mt. Baker NF** | 0.8 | $49.96 | $11.82 | $29.35 |
| **Vancouver Region BC** | 24.8 | $5.94 | none | ( $0.67) |
| **Okanagan NF** | .5 | $27.74 | $6.52 | $13.99 |
| **Colville NF** | .6 | $21.56 | $4.85 | $7.79 |
| **Kamloops Region BC** | 8.6 | $7.80 | none | ($0.06) |
| **Panhandle NF** | 1.2 | $24.93 | $5.07 | $10.55 |
| **Kootenai NF** | 1.0 | $18.87 | $3.66 | $3.64 |
| **Flathead NF** | .4 | $18.62 | $3.95 | ( $2.83) |
| **Nelson Region BC** | 7.1 | $5.76 | none | ($0.62) |
| **Prince George Region BC** | 15.3 | $11.17 | none | $4.11 |
| **Cariboo Region BC** | 9.1 | $5.08 | none | ($1.13) |
| **Summaries** | | | | |
| **All Washington State NFs** | 5.5 | $39.86 | $9.54 | $22.80 |
| **All Idaho NFs** | 3.5 | $19.85 | $4.05 | $5.01 |
| **All Montana NFs** | 2.3 | $16.43 | $3.28 | ($4.20) |
| **All U.S. NFs Nationwide** | 54.2 | $32.76 | $7.32 | $16.00 |
| **All B.C. Public (Crown) Forests** | 75.6 | $8.25 | none | $1.88 |

Note: NF = National Forest; BC = British Columbia; (   ) indicates a negative or deficit number. Net = Revenues minus costs. Source: Timber Sale Program Information Reporting System (TSPIRS) (1988/89), U.S. Forest Service; Ministry of Forests, British Columbia, Annual Report (1988/89). B.C. logged 75.6 million cubic metres of public timber and produced net revenue of $1.88 per cubic metre. The NFs, on adjacent states, logged 13.4 million cubic metres and produced net revenue of $10.53 per cubic metre. Major differences between the two jurisdictions are competitive bidding on all NFs, major roads on NFs are amortised over full rotation, silviculture and roads partly paid for by B.C. companies, and 25 % of NF gross revenue paid to counties. In 1984, TSPIRS was mandated by the U.S. Congress to require the USFS to address the issue of "below-cost" (where revenues are below the costs of timber sales). The question of most appropriate "revenue-cost assumptions" is controversial both in the U. S. and Canada. In FPC's analysis, the TSPIRS appears to be the most acceptable measure to date. TSPIRS is a procedure used to help make better forest economic decisions. B.C. costs include Victoria "overhead" of $1.88. In the adjoining States, National Forests comprise only about 27 per cent of the total state-wide forest land base.

## COMPARISON OF TIMBER HARVEST PRICES

Between Westside R-6 Forest Service with
Coastal British Columbia & Eastside R-6
Forest Service with Interior British Columbia
1/ Fiscal years 1986 - 90 & 1st Quarter 1991

| Fiscal Year | Westside R-5 $US/MBF | 2/ Coastal B.C. $US/MBF | Difference in Price $US/MBF | Difference since FY86 $US/MBF |
|---|---|---|---|---|
| 1986 | 130 | 18 | 112 | - |
| 1987 | 105 | 25 | 80 | -32 |
| 1988 | 124 | 40 | 84 | -28 |
| 1989 | 174 | 40 | 134 | +22 |
| 1990 | 198 | 44 | 154 | +42 |
| 1st Qtr. 1991 | 254 | 46 | 208 | +96 |

| Fiscal Year | Eastside R-6 $US/MBF | 2/ Interior B.C. $US/MBF | Difference in Price $US/MBF | Difference since FY86 $US/MBF |
|---|---|---|---|---|
| 1986 | 80 | 6 | 72 | - |
| 1987 | 95 | 7 | 88 | +16 |
| 1988 | 111 | 19 | 92 | +20 |
| 1989 | 125 | 34 | 91 | +19 |
| 1990 | 132 | 38 | 94 | +22 |
| 1st Qtr. 1991 | 126 | 41 | 85 | +13 |

1/ All prices converted to B.C. fiscal year from April 1 thru March 31st, i.e., fiscal year 1986 is April 1, 1985 thru March 31, 1986 & 1st Qtr. 1991 is April 1 thru June 30, 1990.

2/ B.C. timber converted from M3 B.C. scale to MBF scribner scale using 5.5 M3/MBF for Coast and 6.1 for Interior. Canadian $ converted to US$ by using average conversion factor for each quarter in B.C. fiscal year.

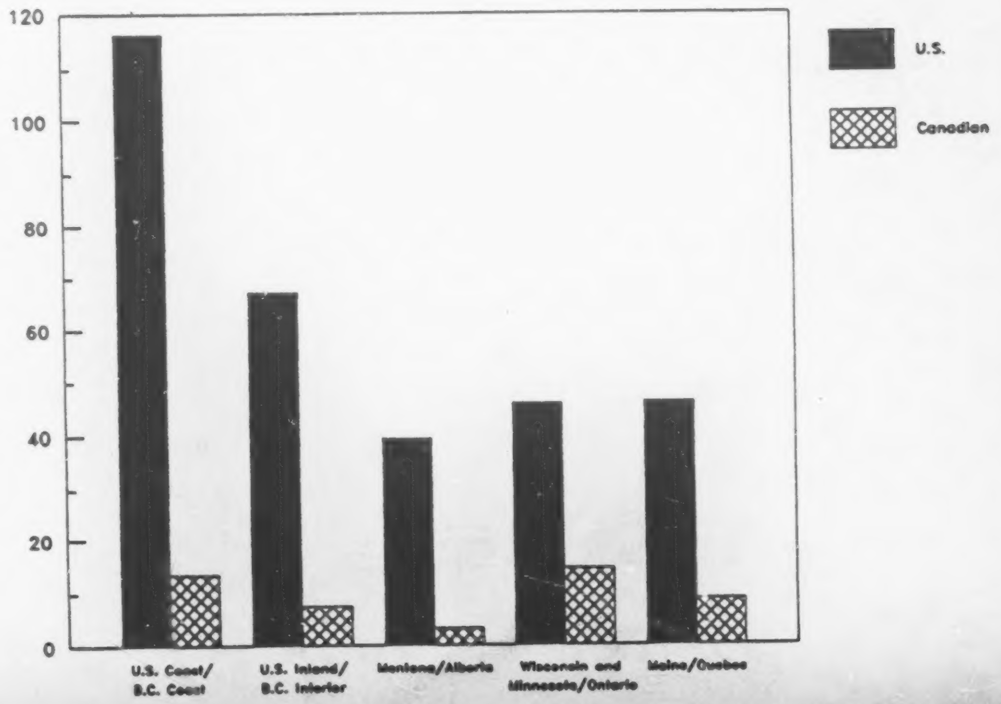
Source: USDA Forest Service - Production, Prices, Employment & Trade in NW Forest Industries, 1986-2nd Qtr. 1990: R-6 Prices, B.C. Prices FY86-88, and scale conversion factors.

U.S. Dept. of Commerce - Import Administration Office of Compliance: B.C. prices FY89-1st Qtr. 1991.

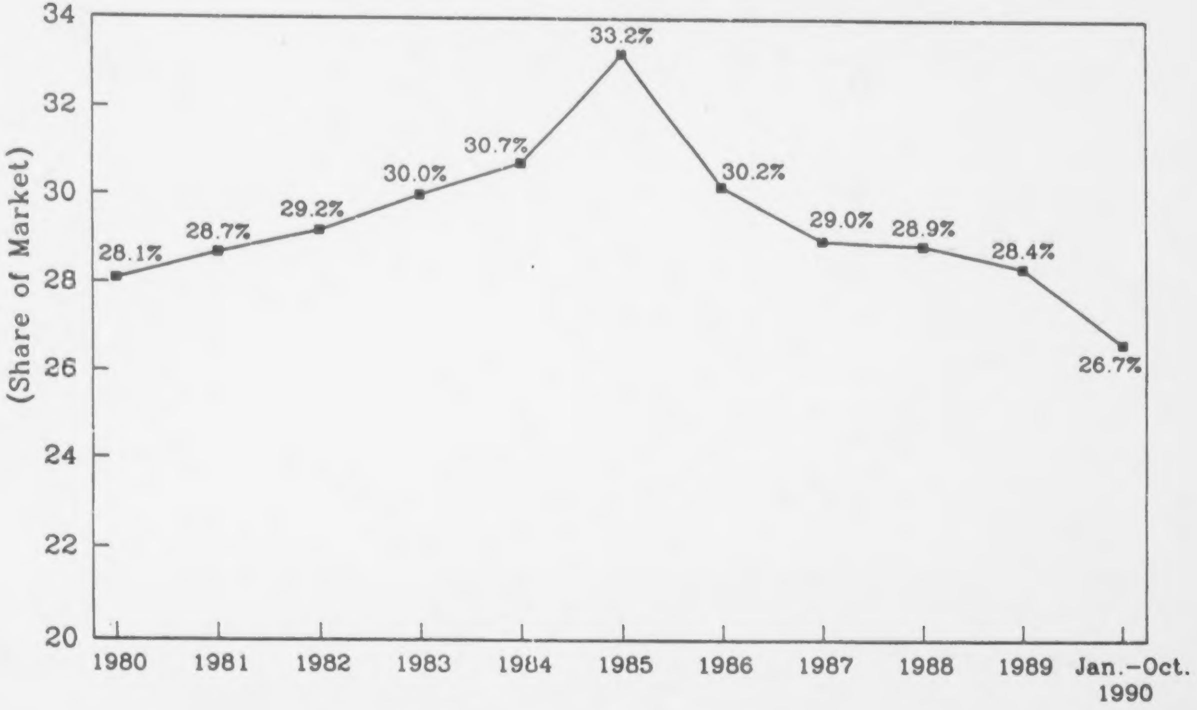
IMF, International Financial Stats: Exchange rates.

# U.S./Canadian Fees on Comparable Timber, 1985

($/MBF Log Scale Scribner)



# CANADIAN PENETRATION OF U.S. SOFTWOOD LUMBER MARKET



### U.S. AND CANADIAN SOFTWOOD LUMBER PRODUCTION, 1978 - 10 MOS. 1990
(in million board feet)

| | United States | | | | Canada | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | South | | West & Other | | British Col. | | Other Can. | | Total | |
| Year | Volume | % | Volume | % | Volume | % | Volume | % | Volume | % |
| 1978 | 9,231 | 18.3 | 22,826 | 45.3 | 12,545 | 24.9 | 5,817 | 11.5 | 50,419 | 100.0 |
| 1979 | 9,283 | 18.6 | 22,149 | 44.3 | 12,517 | 25.0 | 6,038 | 12.1 | 49,987 | 100.0 |
| 1980 | 8,217 | 18.5 | 18,029 | 40.6 | 11,979 | 27.0 | 6,200 | 13.9 | 44,425 | 100.0 |
| 1981 | 8,415 | 20.5 | 16,261 | 39.6 | 10,424 | 25.3 | 5,983 | 14.6 | 41,083 | 100.0 |
| 1982 | 8,754 | 22.4 | 15,033 | 38.5 | 9,944 | 25.4 | 5,345 | 13.7 | 39,076 | 100.0 |
| 1983 | 10,181 | 20.5 | 19,545 | 39.3 | 13,043 | 26.2 | 6,943 | 14.0 | 49,712 | 100.0 |
| 1984 | 10,674 | 20.6 | 20,500 | 39.6 | 13,078 | 25.3 | 7,511 | 14.5 | 51,763 | 100.0 |
| 1985 | 10,730 | 20.0 | 20,591 | 38.4 | 14,004 | 26.1 | 8,252 | 15.4 | 53,577 | 100.0 |
| 1986 | 11,678 | 20.4 | 23,595 | 41.2 | 13,335 | 23.3 | 8,621 | 15.1 | 57,229 | 100.0 |
| 1987 | 12,473 | 19.5 | 25,762 | 40.2 | 15,888 | 24.8 | 9,983 | 15.6 | 64,106 | 100.0 |
| 1988 | 12,676 | 20.0 | 25,454 | 40.2 | 15,572 | 24.6 | 9,695 | 15.3 | 63,397 | 100.0 |
| 1989 | 12,544 | 20.4 | 25,001 | 40.6 | 15,234 | 24.7 | 8,841 | 14.3 | 61,620 | 100.0 |
| 10 mos 1990 | 11,646 | 23.0 | 19,533 | 38.6 | 12,131 | 24.0 | 7,288 | 14.4 | 50,598 | 100.0 |

Source: Western Wood Products Association
Dominion Bureau of Statistics

Prepared by: Northwest Independent Forest Manufacturers 2/11/91

VOLUME OF LUMBER PRODUCTION
(BILLION BOARD FEET)

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| CANADA | 10.8 | 12.3 | 13.4 | 15.0 | 13.0 | 10.9 | 14.9 | 17.2 | 18.4 | 18.6 | 18.3 | 16.6 | 15.9 | 20.3 | 20.6 | 22.3 | 22.0 | 25.9 | 25.3 | 24.1 | 15.7 |
| UNITED STATES | 27.4 | 29.7 | 30.9 | 31.3 | 27.2 | 25.7 | 29.7 | 31.8 | 31.9 | 31.4 | 26.2 | 24.7 | 23.8 | 29.7 | 31.2 | 30.6 | 35.3 | 38.2 | 38.1 | 37.5 | 25.4 |
| CANADIAN SHARE OF TOTAL N.A. LUMBER PRODUCTION | 28.3% | 29.3% | 30.3% | 32.4% | 32.3% | 29.8% | 33.4% | 35.1% | 36.5% | 37.2% | 41.1% | 40.2% | 40.1% | 40.6% | 39.8% | 41.7% | 38.4%[1] | 40.4% | 39.9% | 39.0% | 38.3%[2] |

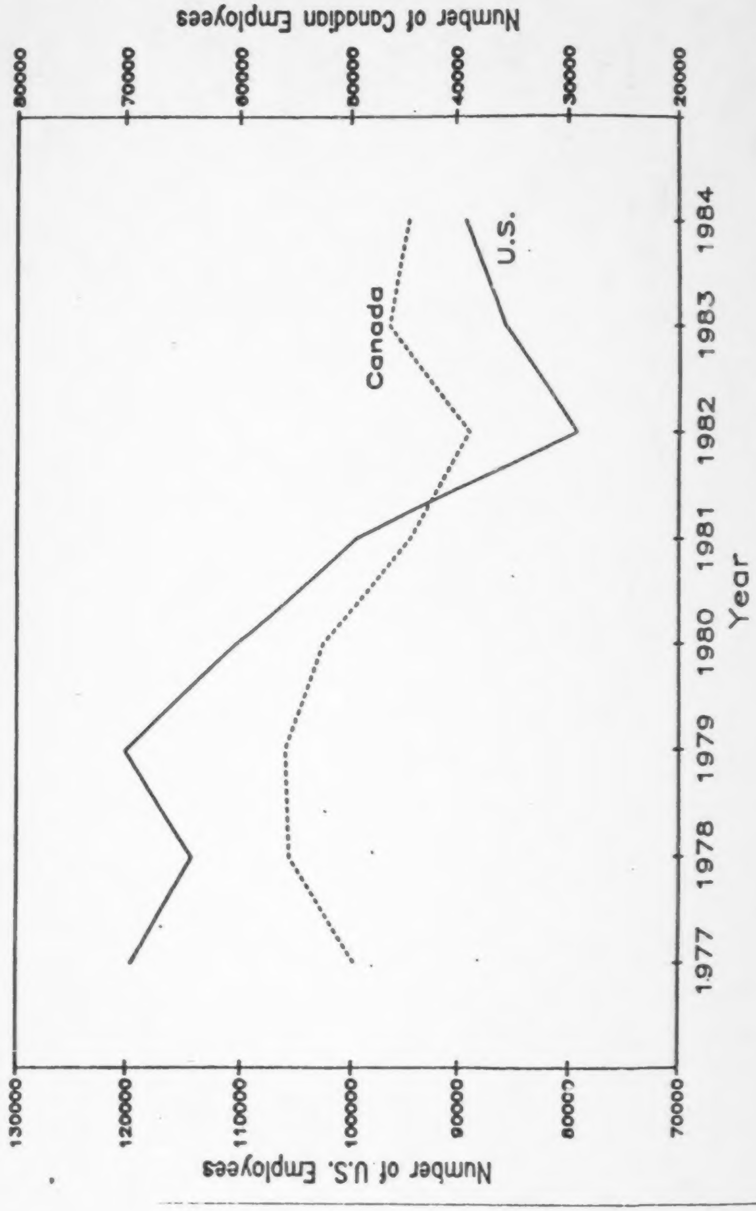
SOURCE: Western Wood Products Association
Dominion Bureau of Statistics

* Production Data for 1990 is only through August, 1990

1/ Canadian share of lumber production dropped in 1986 because of the lumber strike in British Columbia.

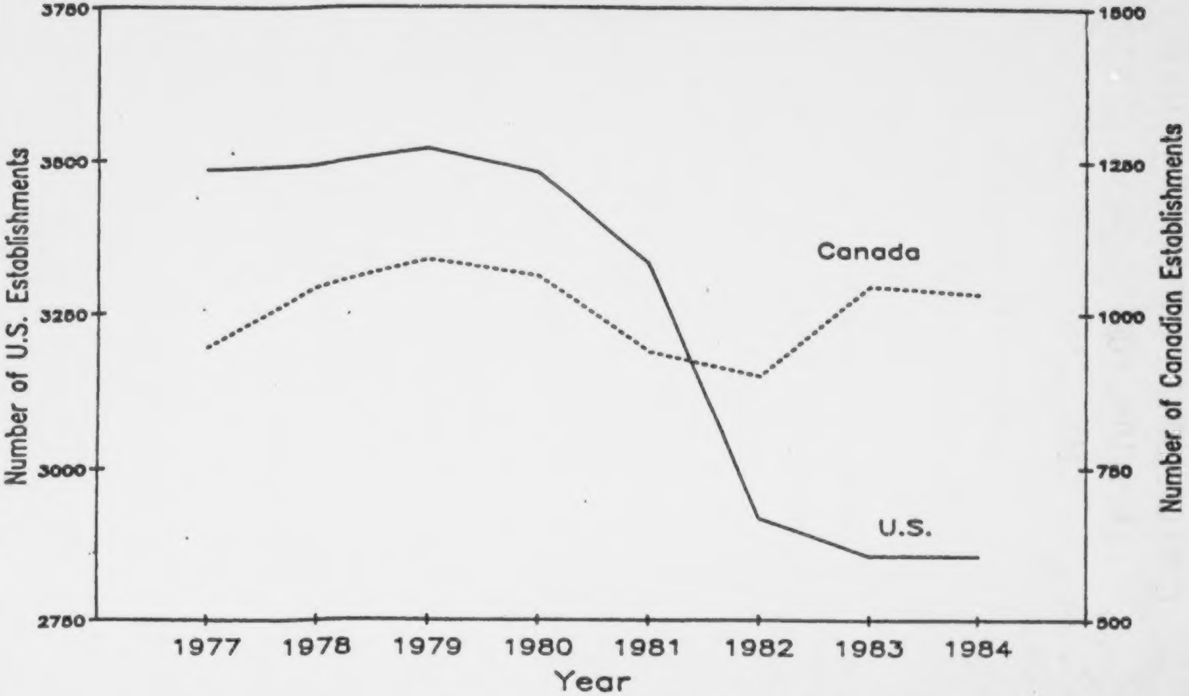
2/ Canadian share of lumber production in 1990 is the lowest it has been since 1979.

SOFTWOOD LUMBER EMPLOYEES
U.S. AND CANADA



Source: U.S. International Trade Commission

# SOFTWOOD LUMBER PRODUCING ESTABLISHMENTS
### U.S. AND CANADA



Source: U.S. International Trade Commission

# U.S.-CANADA SOFTWOOD TRADE: POST-1986 DEVELOPMENTS IN CHANGING MARKETS

**Thomas R. Waggener**
**Professor, Forest Economics**
**and International Trade**
**Center for International Trade in**
**Forest Products (CINTRAFOR)**
**College of Forest Resources**
**University of Washington**
**Seattle, Washington 98195**

**For Presentation at**

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**Subcommittee on Regulation, Business**
**and Energy**
**Committee on Small Business**
**United States House of Representatives**

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**February 22, 1991**

## Introduction

It is a pleasure to appear once again before this Subcommittee to discuss issues important to forest products trade. I am Thomas R. Waggener, Professor of Forest Products Economics and International Trade at the College of Forest Resources, University of Washington in Seattle, Washington. As a member of the University faculty, I also have devoted a substantial amount of my effort to the Center for International Trade in Forest Products over the past seven years, undertaking analyses of major developments in global timber production and international trade. My involvement in studies of Canadian trade date back to 1963, at which time I completed a master's thesis on the topic of Canadian softwood imports into the U.S. and the trade disputes at that time. Needless to say, neither that analysis or the intervening years have resulted in such trade issues disappearing. Hopefully, however, we understand the dynamics of that trade much better, and have established more effective mechanisms for dealing with trade disputes.

The Center for International Trade in Forest Products was established at the University of Washington, Seattle, Washington in 1984 to assist in the analysis of forest products trade worldwide, and to provide information to government and business which helps to develop a better understanding of trends and developments influencing the domestic forest products sector and to establish effective public policy for this sector.

It is timely to examine developments since 1986 in terms of our trade in softwood lumber products with Canada, our largest trading partner and a significant source of timber products for U.S. consumption. As is well known, the U.S. and Canadian governments entered into a "Memorandum of Understanding" in December 1986 seeking to avoid the imposition of a 15 percent import duty on Canadian softwood lumber destined for the U.S. domestic market. This action followed the October 1986 finding by the U.S. International Trade Administration that the prevailing Canadian timber pricing and allocation policies did violate U.S. trade law and constituted a subsidy, thereby warranting a countervailing duty.

The subsequent market dynamics during the period 1986-90 are the subject of this testimony. In brief, this analysis examines:

1) The dynamics of U.S. and Canadian lumber production during the 1986-90 period.

2) The consumption of softwood lumber in the U.S.

3) The responsiveness of realized prices by U.S. sawmills in the Pacific Northwest in response to market dynamics.

4) The behavior of "FOB Border" prices implicitly faced by Western Canadian producers seeking to compete in the U.S. market,

5) The impact to changes in the U.S.-Canadian exchange rate on realized timber prices, and:

6) The magnitude of fiscal impacts potentially imposed on Western Canadian softwood producers due to the 15 percent duty and/or economic cost alternatives.

Each of these points is reviewed briefly in the short sections below and are visually illustrated in the figures attached. Reference to the figures will be provided as appropriate.

## I. The Dynamics of the Lumber Production

The consideration of a countervailing duty in late 1986 came at a time when the North American forest products industry was emerging strongly from the economic recession of 1981-82. The industry had enjoyed relatively prosperous times through 1976-1979, and then experienced a sharp decline in demand as housing markets collapsed in 1980-82. This collapse was reflected in both U.S. and Canadian softwood lumber production.

Figure 1 illustrates U.S. softwood lumber production during the 1975-90 period by major producer region. Production exceeded 30 billion BF from 1976-79. As the effects of the recession set in, however, the U.S. production dropped rapidly, falling to less than 24 billion BF in 1982. With lowering interest rates and increasing housing demand, production then increased steadily between 1982 and 1988. It was in the middle of this rise that the Canadian-U.S. Memorandum was approved. Production rose to over 49.5 billion BF in 1988, almost one-third more than production at the 1979 peak. Subsequent to 1988, however, the U.S. softwood lumber industry again faced stagnation and decline in demand, with production dropping about 36 billion board feet in 1990, still well above 1979 production levels.

Reflecting a strong tie to the U.S. softwood market, the Canadian forest industry did not escape the market dynamics described above. Production in Canada climbed from just over 11 billion (BF) in 1975 to almost 20 billion BF in 1979, coinciding with the peak U.S. production. With the economic recession, production dropped to 15 billion BF (Figure 2). Thus production declined approximately 25 percent in both the U.S. and Canada.

Canada also shared in the strong market recovery of 1982-88, with production increasing well above prior peak (1979) levels. While production in Coastal BC reflects this general pattern, significant gains accrued to the industry in interior B.C. and eastern Canada (Ontario and Quebec).

## II. The U.S. Consumption of Softwood Lumber

As noted, production trends reflect markets -particularly the U.S. domestic market. That market is, in turn, highly volatile and responsive to interest rates and housing/construction cycles.

The consumption of softwood lumber in the domestic U.S. market is shown in Figure 3. Consumption peaked in 1978, at the end of the then-current business cycle. Consumption reached 42.6 billion BF before the downturn, subsequently falling to 31 billion BF in 1982. The relative contributions to consumption by U.S. and Canadian production is shown in Figure 3 and is displayed graphically as market share in Figure 4. Even though consumption was increasing from 1975-78, the U.S. share of that consumption was actually decreasing, from over 82 percent in 1975 to only 72 percent in 1978. Thus U.S. producers shared relatively less in the growing market during the 1974-19 recovery.

Market share remained about 72 percent for 1978-80, before declining further as the market sank into recession. The market share for Canadian imports reached 30 percent 1982-83, the bottom of the business cycle. As recovery began, so did the penetration of Canadian softwood imports, with the U.S. market share declining further to 67 percent in 1985, the time of the second petition by the U.S. industry for relief. Nevertheless, the U.S. industry experienced an increase in the absolute volume going into U.S. consumption, from 22 billion BF in 1982 to almost 36 billion in 1987, an increase of over 60 percent.

Following the 1985 petition and subsequent ruling, the Canadian market share declined even while total consumption was increasing. Market share fell to 30 percent in 1986, and to just over 28 percent in 1989. For the first nine months of 1990, the market share is estimated at 26.7 percent.

The position of the U.S. Western region is shown graphically in Figure 5. Although production has been strong, the market share has declined steadily from about 22 percent of U.S. consumption to 16 percent in both 1982 and again in 1989. The Western region gained slightly in the recovery period but remained below 18 percent in share. In addition to the gain in Canadian share, the most significant increase was experienced by the U.S. South (Figure 6). which climbed from a market share of about 20 percent in 1976 to over 25 percent in 1988-89. This competitive restructuring of U.S. regions is not evident in total domestic share of consumption yet is critical to the present position of both Western U.S. and Western Canadian industry interests.

The Western U.S. production (Coast and Inland) is graphically displayed in Figure 7. Production peaked at 21.5 billion BF in 1987 to just under 20 billion BF for the first 11 months of 1990. As the Western U.S. region emerged from the 1981-82 recession, production rapidly pressed capacity as illustrated in Figure 8. By 1986, both the Coastal and Inland subregions were essentially at full capacity. In 1988, however, utilization rates started to fall, declining most significantly in the Coastal subregion but declining to below 80 percent throughout the U.S. West by November 1990.

## III. Northwest U.S. Prices

As a sector clearly reflecting the economic business cycles, it is expected that both production and price will be impacted by downturns and recovery periods. This is evident for the Western U.S. industry as illustrated in Figure 9. Prices fell sharply after 1979, and recovered only slowly and modestly in the 1982-89 upturn in production and consumption. As shown in Figure 9, average index prices (FOB Mill, $US/MBF, Coastal Green & Dry Hem-Fir, Inland Ponderosa Pine Coast-Inland North) increased over the 1986 - mid 1989 period, reaching almost $300/MBF on the Coast and just over $500 for the inland region in the spring of 1989. As the market softened, however, so did price realizations, with average prices declining to $240 on the Coast and to $402 for the Inland region.

Western U.S. mills are themselves regional exporters, to the rest of the U.S. and increasingly to offshore markets. However, the "home" market in the Western U.S. is of primary interest and importance. Figure 10 illustrates developments over the past business cycle in this critical market.

Shipments by both U.S. Coastal and Inland mills to the Western market reflect strongly the business cycle. Shipments increased from under 4 billion BF for each subregion to over 5.5 billion BF each by the peak markets of 1978-79. Shipments dropped again to under 4 billion each in 1982. With the national recovery in consumption, shipment again went up to the Western region, equalling the previous peak in 1985-85 before climbing to about 6.5 billion BF each in 1988. Canadian shipments into the Western market have been more modest, reflecting in part the stronger competition from "home" producers. Nevertheless, shipments exceeded 1 billion BF from 1977-1982, then grew strongly to almost 2.7 billion BF in 1988. Although Canadian shipments to the Western market dropped in 1986 (at the time of the ITC review), shipments increased strongly in 1987-88. This overall penetration of the Western U.S. market represents a gain in comparative Canadian market share based on the three competing producer regions from about 10 percent in 1976 to over 17 percent in 1988.

## IV. Implicit U.S. Prices for Western Canada in Canadian Terms

Canadian producers seeking to ship into the U.S. market face highly competitive U.S. prices. In economic terms, such producers are effectively "price takers", thus unable to adjust asking price significantly to reflect either production costs or transportation.

The Western U.S. mill realization prices noted above (Figure 9) can be viewed a reasonable proxy prices for producers in Coastal and Interior Canada. The U.S. prices are quoted as FOB Mill, thus net of transportation to final markets. In a similar way, these prices can be interpreted as approximate FOB Border prices for Canadian producers.

Using the above analogy for pricing, it is possible to transform prices from US dollars to Canadian dollars in expressing the proxy realization price to Canadian producers. It must be kept in mind that this price index is approximate and species and quality differentials are frequently important.

Figure 11 clearly shows the impact of changing exchange rates for the US/Canadian dollar. In 1986, at the time of the "Softwood Memorandum" the exchange rate was $C1.38 per $US1.00 (December 1986). The average for all of 1986 was $C1.39 per $US1.00). Had this exchange rate been maintained, the equivalent realized Canadian prices would have been as illustrated in Figure 11 and identified as "Coast Const" and "Inland Const" respectively.

The trends identified above represent theoretical mill realizations from selling at prevailing U.S. prices converted to "constant" 1986 Canadian dollars. The fluctuations in price trends for the Coastal and Inland regions reflect, in this case, only changes induced by market fluctuations - the same influence faced by U.S. Northwest producers. Thus, converted price trends generally increased in parallel with U.S. prices, peaking in early spring, 1989 before declining into 1990.

However, the exchange rate between Canada and the U.S. did not remain stable.

## V. Impact of Changing U.S. Canadian Exchange Rates

Figure 11 also illustrates the impact of the changing exchange rates since 1986. The Canadian dollar weakened against the U.S. dollar through early 1986, when the exchange rate was 1.41 (January 1986). A weakening Canadian dollar had helped fuel the export of lumber into the U.S. since a lower U.S. price would yield equal or greater returns expressed in Canadian terms. However, the Canadian dollar started showing strength (the U.S. dollar weakened) after a period of relative stability from April through December 1986. The exchange rate had dropped to 1.31 by the end of 1987, to 1.19 by December 1988, to 1.16 by December 1989, and below 1.15 in September 1990. This decline simply means that a U.S. dollar buys less Canadian dollars. Over the December 1986 - September 1990 period, the decline in U.S. dollar "purchasing power" in Canadian terms dropped by $C0.235 or just over 17 percent. The significance, of course, is that a U.S. dollar received from lumber sales within the U.S. market yielded fewer Canadian dollars for the shipper.

The trends in "current" or adjusted Canadian price realizations for the Coastal and Inland price trends are also shown in Figure 11. Since 1986 exchange rates were used as the base, there is no difference until 1987. At that time, the erosion of the exchange rate, working adversely to Canadian producers, is clearly evident. Although prices fluctuated (as would be expected) in response to short run market influences, the "gap" between current and constant Canadian dollar realization is clearly evident.

## VI. Estimated Fiscal Impacts on Western Canadian Softwood Lumber Exporters since 1986

Facing a dropping exchange rate results in an erosion of lumber sales realization for Canadian producers just as surely as a decline in price. This was shown in Figure 11. However, Canadian producers also faced a 15 percent "surcharge" as a result of the 1986 countervailing duty case and the ensuing Memorandum of Understanding. Initially, the U.S. was positioned to collect a 15 percent import tax at the border, thus enriching the U.S. treasury. The Memorandum of Understanding provided for an equivalent Canadian export tax on shipments to the U.S. - thereby potentially keeping the tax revenue in Canada. The Memorandum of Understanding also allowed the Provinces to adjust timber sales prices and sales conditions in lieu of the Canadian export tax. In theory, all such changes were expected to yield an approximate 15 percent reduction in realizations from the U.S. marketplace.

As noted above, Canadian producers are virtual "price takers", reacting to the equilibrium prices dictated by the competitive structure of the huge U.S. domestic marketplace. It is not possible to "pass forward" any significant portion of cost increases under such competitive market conditions. Canadian mills, therefore, faced the prospect of yielding 15 percent of their realization at the border, or alternatively facing rising costs of approximately this magnitude which could not be passed on to consumers. In either case, they realized less net revenue from export sales to the U.S.

Reduced price realizations would, of course, lead to revisions in export plans and reduction in export volume (and potentially production). To some extent, this was the objective of the Memorandum of Understanding. Any modest reduction in Canadian Imports due to the duty/tax would cause a slight shift in U.S. market equilibrium conditions, affording U.S. producers to capture slightly higher prices and larger sales volume.

Figure 12 illustrates for Coastal Canada the hypothetical imposition of a fully compensating reduction of 15 percent in price realizations based on current Canadian dollar equivalents. Similarly, Figure 13 provides the equivalent 15 percent reduction in realizations for the Inland Canadian producers, based on the proxy U.S. actual price realizations.

From Figures 12 and 13, it is apparent that the double influences of exchange rate adjustments and potential duty/tax under the Memorandum of Understanding have substantial and increasing significance. Although the duty/tax impact was the most significant in the years immediately following 1986, the growing difference between constant and current Canadian dollar realizations has taken a more pronounced "bite" and actually exceeds the impact of the duty/tax after mid - 1988.

The dual impact of exchange rates and duty are perhaps more clearly illustrated in **Figures 14 and 15.** As stated before, the "constant dollar" price realization represents the anticipated Canadian returns in the absence of any change in either exchange rates or imposition of the 15 percent duty/tax. It must be remembered, however, that the constant dollar realization itself is subject to market fluctuation as the U.S. market price changes. Realizing that this is so, it is possible to estimate how much the actual realization would differ from the projected constant dollar realization due to both exchange rate and duty/tax.

Figure 14 shows this relationship for Coastal price realization. A value of zero illustrates the realization of the actual constant dollar return - the situation that prevailed in 1986 prior to the Memorandum of Understanding. With the advent of the 15 percent duty/tax, realizations in Canadian dollars dropped immediately by almost $C43, with an additional "loss" of $C6 due to exchange rate movement. Over time, the exchange rate erosion has increased, reaching an estimated $C60 per MBF after mid - 1988. The combination of these two effects clearly illustrates the difficulty faced by Canadian Coastal producers.

Figure 15 provides a companion analysis of reduced price realizations for inland mills. Due to higher average price realizations on U.S. sales (the proxy price trend used for the Inland region), the impact of both the exchange rate changes and the 15 percent duty/tariff are more pronounced. Total Canadian realizations would have eroded steadily since the beginning of 1987, with exchange rate impacts equalling or exceeding duty/tax induced reductions after mid - 1988.

Total "lost" realizations for the Coastal region of over $C100 per MBF since the spring of 1988 and over $C150 per MBF for the Interior region would have serious impacts on forest industry profitability, and particularly international competitiveness.

It is impossible to fully estimate the fiscal impacts of the above changes in price realization. The order of magnitude of the possible effects can be approximated under the situation as described. It is cautioned that these estimates are both preliminary and subject to the conditions identified relative to proxy Canadian price indexes based on U.S. mill realizations and the full implementation of a compensating 15 percent tax/cost adjustment surcharge in lieu of a U.S. collected import duty.

Price-induced changes in the quantity of Canadian exports to the U.S. were not estimated here, and are not incorporated in these estimates. Clearly, larger volumes would have been potentially exported in the absence of either exchange rate erosion or duty/tax imposition. The estimates presented here reflect the lost price realization on actual volumes exported under actual existing conditions. However, the reduction of exports to the U.S. is partially compensated by greater concentration on other markets. As would be expected, competition with Canadian lumber became much more pronounced in Japan, a common marketplace for both U.S. Northwest producers and those in Western Canada.

The estimated loss of revenue from exchange rate differences for Coastal producers, when compared with hypothetical prices expressed in constant 1988 Canadian dollars, amounted to approximately $C15 per thousand board feet of lumber in 1987, $C40 for 1988, $C57 for 1989, and approximately $C55 as of November 1990, the latest date for which relevant data is available.

The corresponding loss of potential revenue of Western Canadian inland mills due to exchange rate adjustments was approximately $C29 per thousand board feet in 1987, $73 in 1988, $C94 in 1989, and $92 as of November 1990.

Based on the estimated volume of softwood lumber shipments to the U.S. from British Columbia coastal and inland mills of 9 billion board feet per year in 1987-88, the implicit loss of industry revenue from exchange rate fluctuations amounted to about $C220 million in 1987, and $C558 million in 1988. Eroded revenues in 1989-90 are undoubtedly more significant, as realized prices were further impacted by exchange rates. Although final 89-90 import figures from British Columbia were unavailable at the time of preparing this analysis, the implicit loss of revenue approximates $C612 million for 1989 and $C497 million for 1990 based on estimated U.S. imports of 7.5 billion and 6.3 billion board feet respectively. These estimates do not, of course, reflect unrealized sales due to lessened competitiveness.

The implicit impact of a duty/cost at a full 15 percent of potential realized lumber price has also reduced realization of net revenue from Western Canadian sales in the U.S. marketplace. It must be noted, however, that this is a fransfer from producers to the Province. For the coastal BC region, the implicit impact is estimated at $C46 per MBF for 1987 and 1988, $C49 per MBF for 1989, and $C45 for 1990. Inland differentials are approximately: $C91 (1987), $84 (1988), $C81 (1989) and $C75 (1990). The implicit loss of industry realized revenue is estimated at approximately $C2.2 billion based on estimated export volumes to the U.S. market.

Taken together, it is estimated that the loss of mill realization value could approach $C4 billion over the four year period since the "Memorandum of Understanding" on softwood lumber. By any account, this is a significant impact on the Western Canadian forest industry. Almost half of this impact, and a rapidly growing share, moreover, is associated with exchange rate movements unrelated to the softwood lumber industry directly. Since it is this component of declining price realizations that has increased dramatically since spring 1988, it is perhaps the leading contributor to a changing current economic position for the Canadian industry as North American markets weaken, with declines in both production and prices.

The North American forest products industry will also continue to face change, and will experience strong cyclic effects. Weathering those cycles is a characteristic feature of market performance. The markets experienced in 1989-90 reflect the classic elements of such cycles. The situation for Canadian producers is accentuated by the significant and continuing changes in exchange rates, reflecting broader macroeconomic factors beyond the control of the forest industry in either country. At the moment, the movements favor U.S. producers. At another point in time, such as the recovery for the last economic cycle (1974-79) exchange rate movements strongly favored Canadian mills - a trend that extended almost to 1986.

The U.S. forest products industry is not without economic difficulties in the Pacific Northwest. Declining markets and prices, coupled with tightened public timber supplies due to owl habitat conservation and revised national forest land use plans, coupled with major shifts in log export policy, place the U.S. regional industry in a tightening price-cost squeeze. Increasing competition for shrinking markets, and the search for profits, can be anticipated to continue for both U.S. and Canadian producers.

## SUMMARY

The major conclusions of this analysis can be summarized as follows:

- The duties initially imposed in December 1986 came at a time where the North American forest products industry was climbing out of the depths of a major recession. The turning point was 1981-82; hence both the Canadian and U.S. lumber industries were experiencing substantial market recovery at the time of the lumber decisions;

- The lumber industry, driven by expanding U.S. consumption, resulted in large increases in production in both the U.S. and Canada, with growing absolute imports from Canada but which represented a declining market share after 1985.

- Structural changes were taking place in market shares for major U.S. production regions. The Western U.S. Coast region was losing market share, while the U.S. South, and to a lesser extent, the U.S. inland region gained market share.

- Canadian producers are largely "price-takers", faced with competing at established prices in the U.S. marketplace. As a highly competitive market, both U.S. and Canadian sawmills are largely unable to pass cost increases forward to consumers.

- The Canadian forest products industry has seen significant erosion of realized returns from the U.S. market since 1986 due to the changing exchange rates. Rates more favorable to the U.S. have meant that Canadian producers receive a lower return in Canadian dollars from selling in the U.S. market. It is estimated that the "exchange rate effect" has grown to the point where it exceeds the economic burden of a 15 percent duty/cost adjustment for Western Canadian mills.

- Losses of mill realization from exchange rate impacts are quite significant. While the estimates of potential lost revenues from U.S. sales are far from precise and should not be taken literally, the results do portray the loss of competitiveness due to the erosion of the Canadian dollar in terms of the U.S. dollar. Overall, the magnitude of the "loss" of potential revenue for Western Canadian producers for 1987-90 approaches $C1.9 billion.

- The dynamics of the business cycle, and the resulting impact on U.S. lumber consumption has dramatically impacted softwood lumber producers on both sides of the border. U.S. and Canadian industry have seen a strong rising market during the 1986-88 period during which volumes have increased substantially but with prices increasing only moderately. The early signs of recession impacted both industries in 1989-90, with declining consumption and production, with softening prices.

- While Western Canadian producers have suffered losses of realized incomes, the impacts from a fully implemented 15 percent duty are essentially matched or exceeded by the impacts felt from the declining exchange rate.

- The impact of changes in the exchange rate are the most dramatic during the 1988-90 period for both Coastal and Inland Western Canadian producers. The Western Canadian industry will continue to face worsened profitability and market competitiveness at existing exchange rates. Further erosion of the Canadian dollar will make this impact even more severe. Under current policy, this impact on the Canadian Industry is largely a wealth transfer to the Provinces through the recovery of higher timber fees and reduced forest management costs.

- Western U.S. mills are also impacted by declining consumption and erosion of competitiveness with other major producing regions in face of rising costs. Increased competition in the timber industry can be anticipated, particularly at a time when markets are in decline, prices are softened, and total consumption is falling. At the same time, both Canadian and U.S. Northwest producers are facing higher costs, contributing to profit declines and potential operating losses. The sobering fact is that this set of circumstances reflects basic fundamentals of a strongly cyclic industry rather than a bilateral advantage to either side. There is little evidence that actions on either side of the border over the past 24 months have unduly disadvantaged the other.

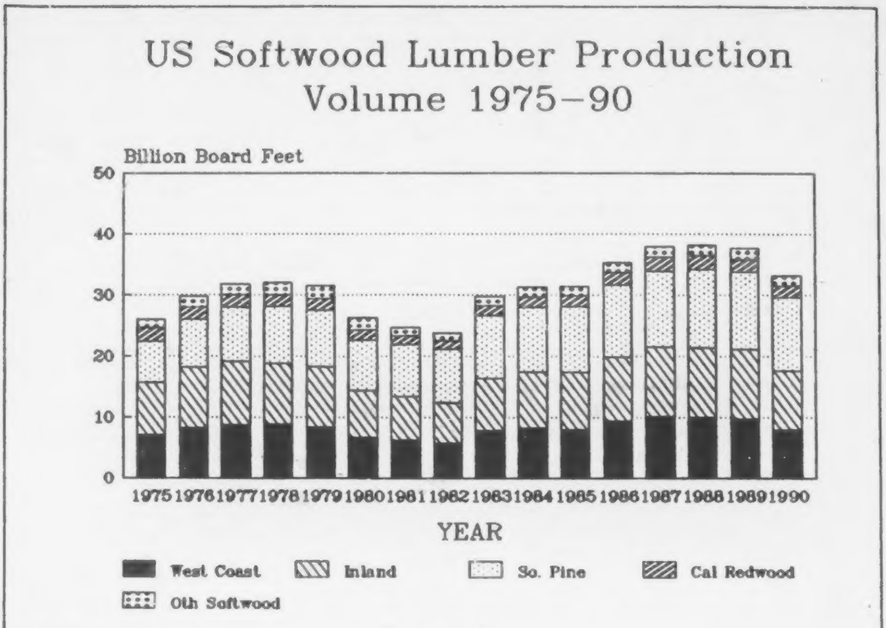


FIGURE 1

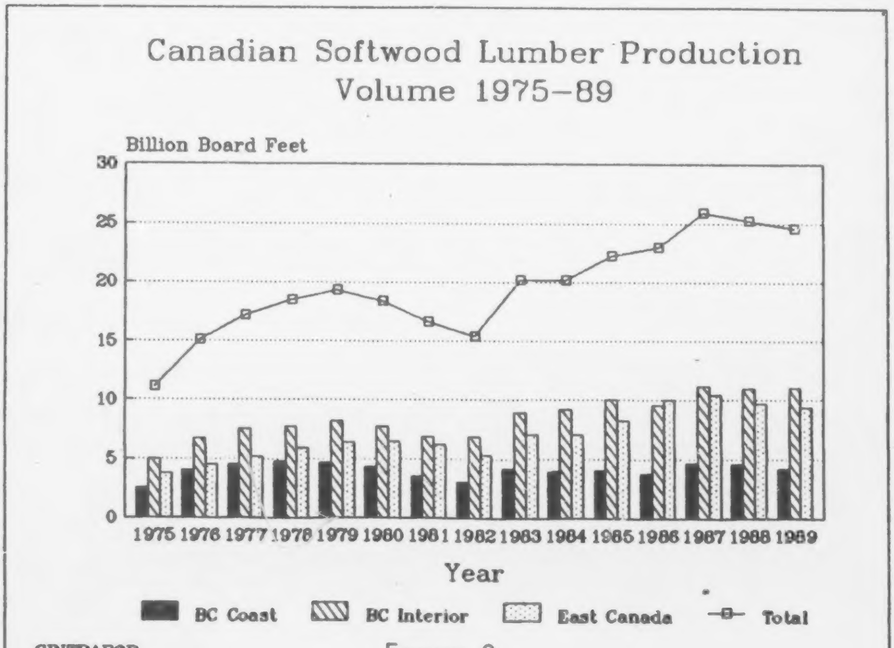
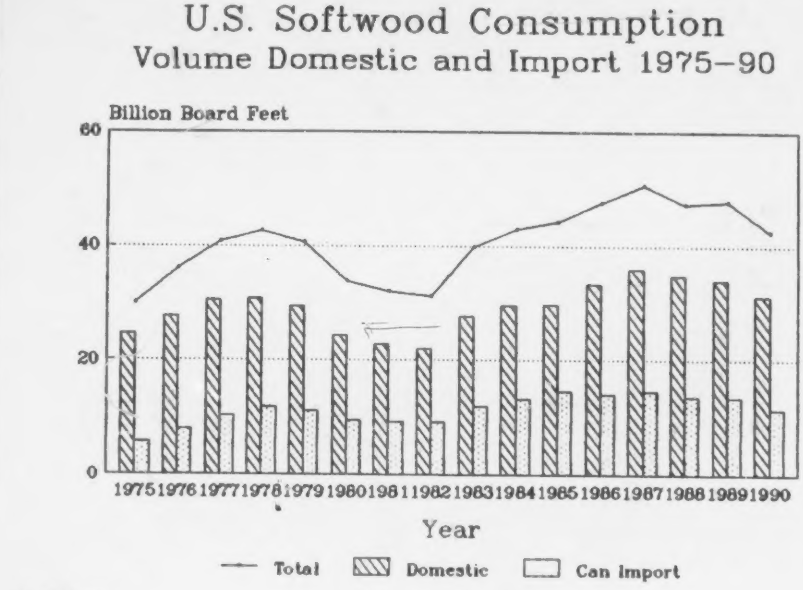


FIGURE 2



CINTRAFOR

FIGURE 3

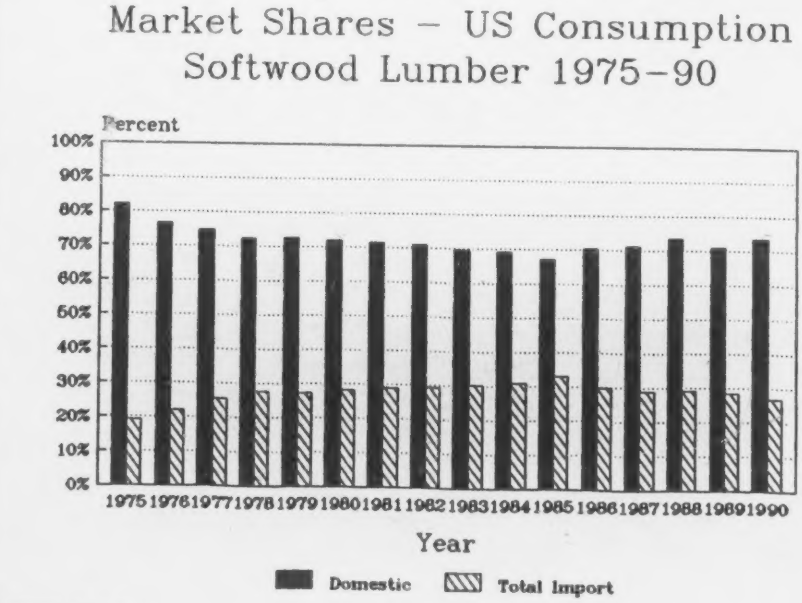


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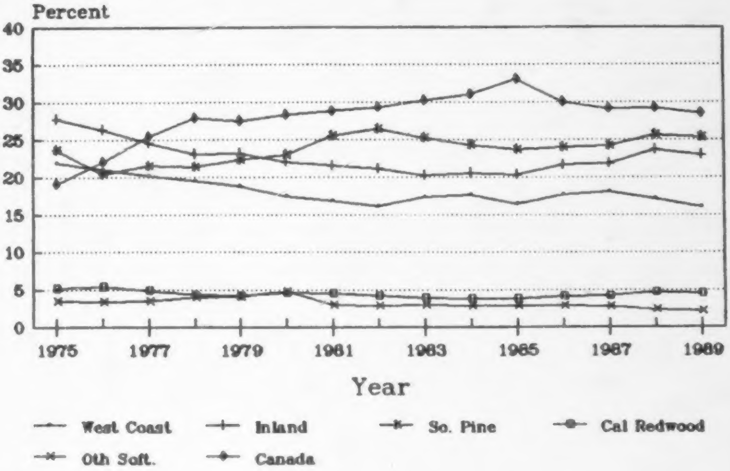
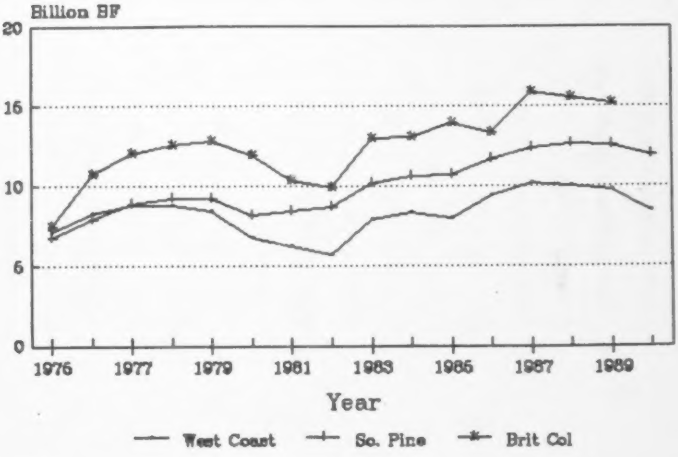
FIGURE 4



US Lumber Consumption by Source
Percent Share 1975-89

CINTRAFOR/trw

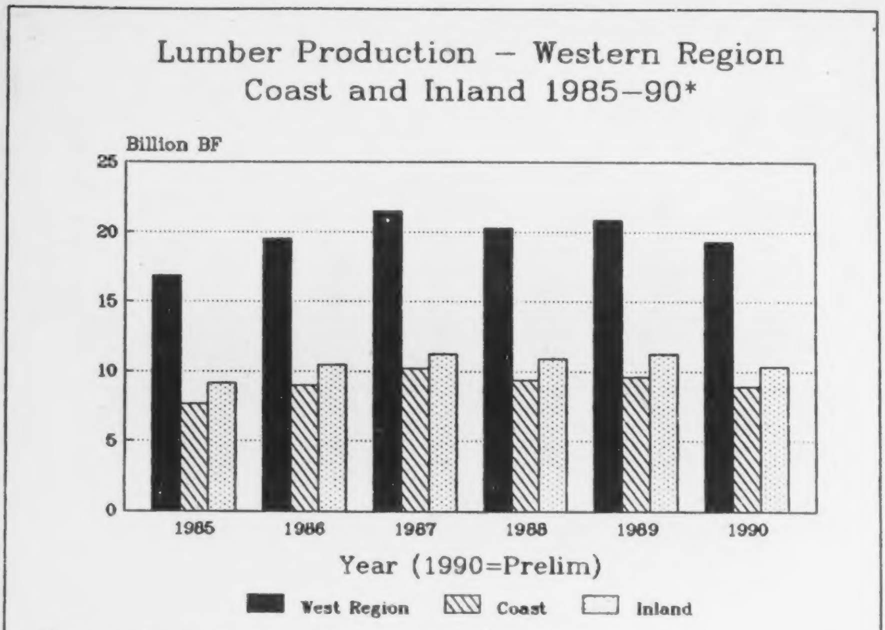
FIGURE 5



Trends in Regional Lumber Production
US and Canada 1975-90

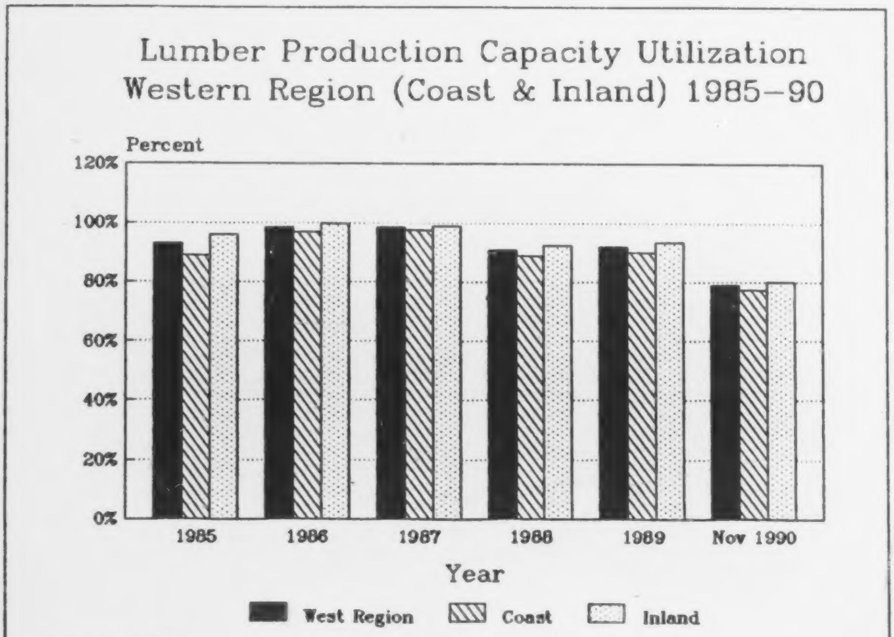
CINTRAFOR/trw

FIGURE 6



CINTRAFOR/WWPA/trw

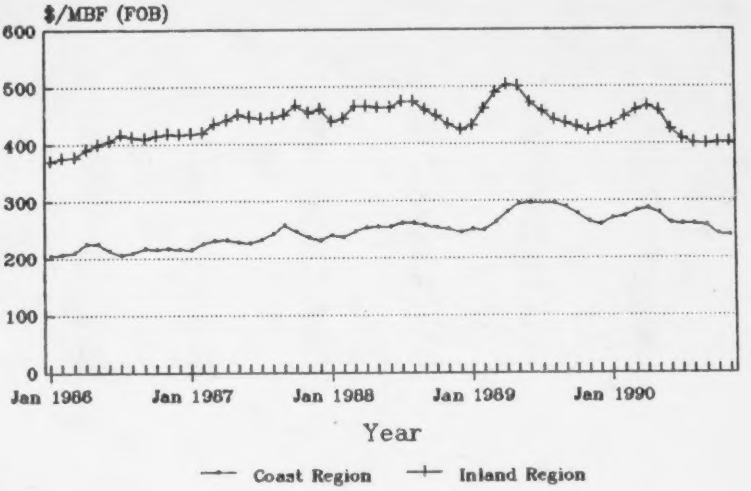
FIGURE 7



CINTRAFOR/WWPA

FIGURE 8

Western Lumber Mill Realization 1986–90
Inland and Coastal (FOB, $/MBF)



CINTRAFOR/WWPA

FIGURE 9

Comparative Softwood Lumber Shipments
to Western Markets 1975–88

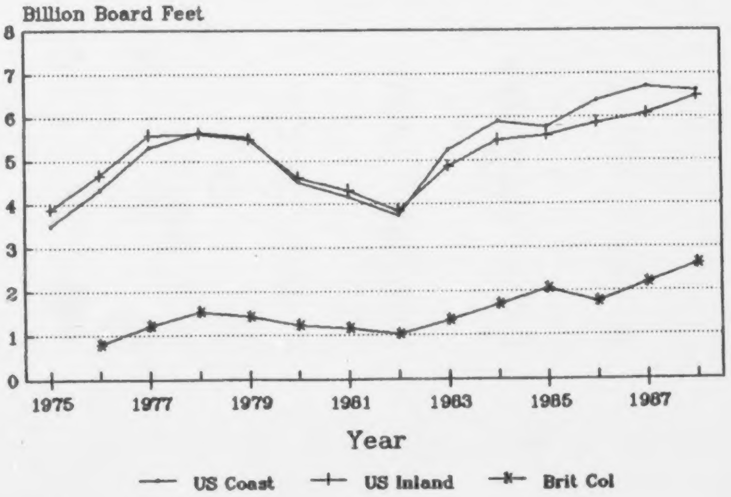


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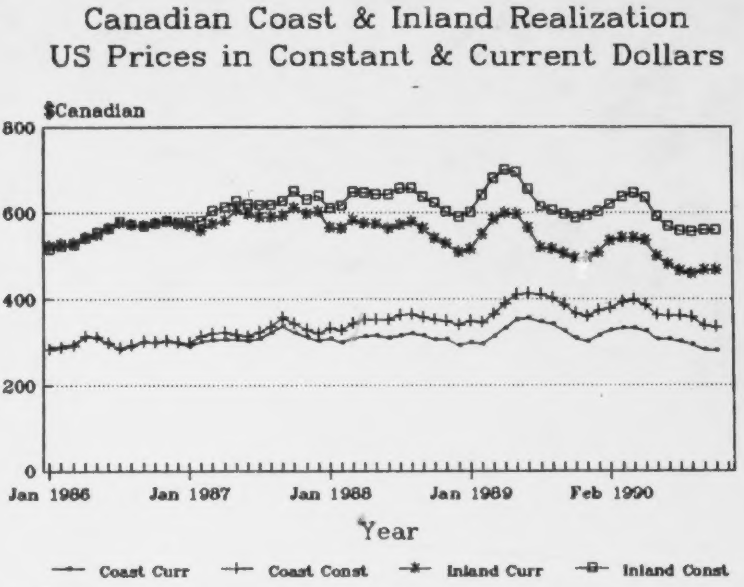
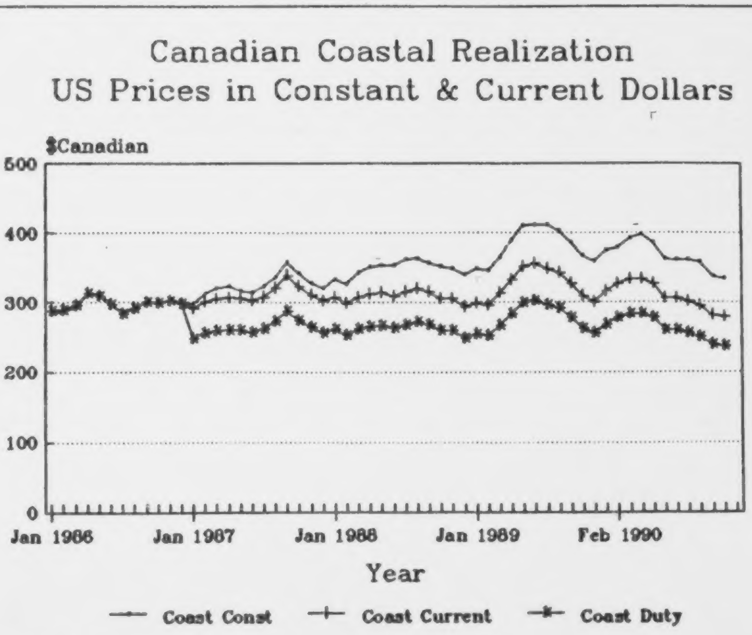
FIGURE 10


Canadian Coast & Inland Realization
US Prices in Constant & Current Dollars

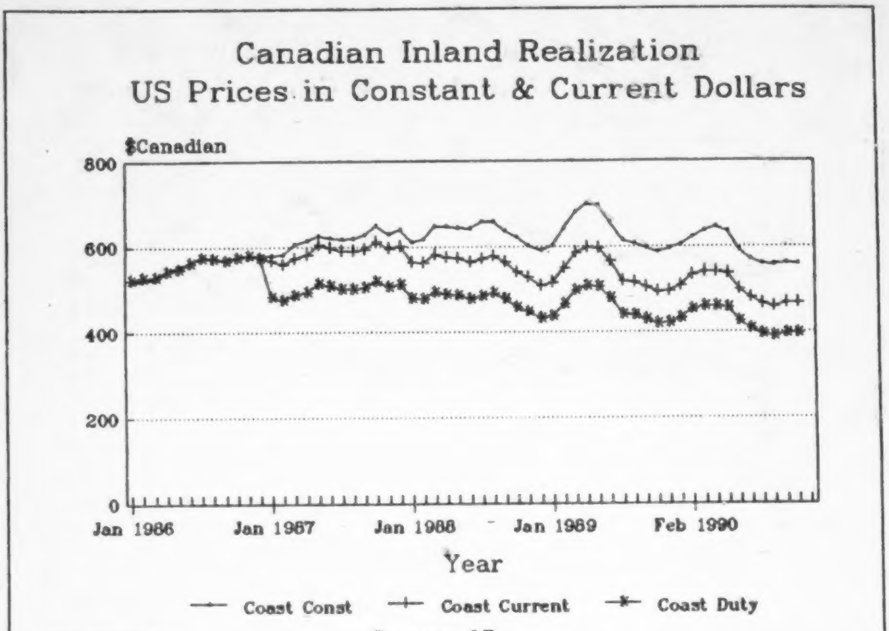
CINTRAFOR/trw

FIGURE 11


Canadian Coastal Realization
US Prices in Constant & Current Dollars

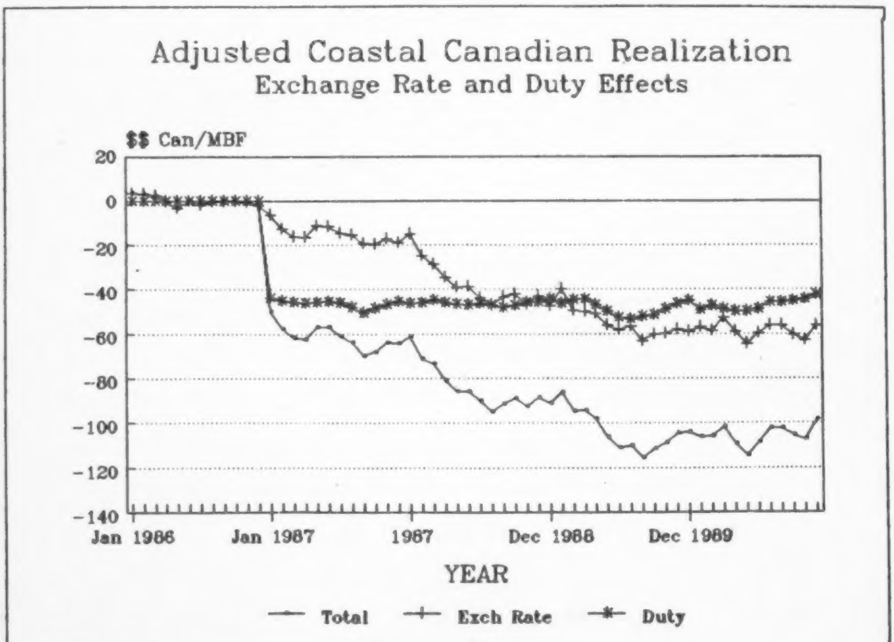
CINTRAFOR/trw

FIGURE 12



CINTRAFOR/trw

FIGURE 13



CINTRAFOR/trw

FIGURE 14

STATEMENT OF
DR. H. FRED KAISER, JR.
DIRECTOR, FOREST INVENTORY, ECONOMICS, AND RECREATION RESEARCH
FOREST SERVICE
UNITED STATES DEPARTMENT OF AGRICULTURE

Before the
Subcommittee on Regulation, Business Opportunities, and Energy
Committee on Small Business
United States House of Representatives

Concerning the of the 1986 U.S.-Canada Memorandum of Understanding on Softwood Lumber

February 22, 1991

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

Thank you for the opportunity to participate in your review of the 1986 U.S.-Canada Memorandum of Understanding on Softwood Lumber.

The USDA Forest Service provided technical advice on the forest products market to the U.S. Department of Commerce as this agreement was being negotiated. In my testimony today, I will review trends in these markets since the Memorandum of Understanding was signed.

## Overall Importation of Canadian Timber Products into the United States

As shown in figure 1, the Canadian share of the U.S. softwood lumber market peaked at 33.2 percent in 1985. It declined in 1986 and continued to decline after the Memorandum of Understanding was signed. Through November 1990, the market share had declined to less than 27 percent.

As shown in figure 2, not only has the Canadian share of the U.S. softwood lumber market declined, but the volume of imports has declined as well. Volume peaked at 14.6 billion board feet in 1987 and declined to 13.5 billion board feet in 1989. Data for the first 11 months of 1990 suggest that this decline in volume will continue.

Based just on market share and import volume, the Memorandum of Understanding appears to be effective in reducing imports from Canada. However, there have been structural shifts in demands and supplies for timber products since the Memorandum of Understanding was signed. These shifts influence U.S. imports of softwood lumber from Canada and tend to mask the direct effects of the agreement on the U.S. demand/supply situation.

## Shifts in Timber Demand

There are three sources of change in demand for timber that have significantly affected imports of Canadian lumber; housing starts, foreign demands for softwood logs and lumber, and gross national product.

### 1. Housing Starts

New residential housing starts account for about one-third of the softwood lumber consumed in the United States each year. The proportion of Canadian imports consumed in this market is even higher. As shown in figure 3, U.S. housing starts peaked at 1.8 million in 1986. The number of starts continued to decline to just 1.2 million in 1990. This decline in the housing market affects both Canadian imports and our domestic industry.

## 2. West Coast Exports

In part because of a strong housing market in Japan and in part because of a weakening of the U.S. dollar compared with the Japanese yen, U.S. exports of softwood logs from the West Coast reached a record high of 3.8 billion board feet in 1988, as shown in figure 4. This upswing in volume started in 1986. Also, figure 5 shows that softwood lumber exports from the West Coast began an upturn in volume in 1986 that reached a peak of over 2 billion board feet in 1989. These exports originate mainly in Washington and Oregon. The strength of foreign markets tends to increase roundwood costs domestically and ultimately the cost of softwood lumber in the United States. This would be an incentive for Canadian producers to maintain exports to the United States, everything else being equal.

## 3. Gross National Product

Although housing starts have declined, growth in the economy for wood products for residential upkeep and improvement helped maintain markets for softwood lumber. As shown in figure 6, the economy as measured by the gross national product, had positive growth until the 4th quarter of 1990.

## Shifts in Timber Supplies

There are two structural shifts in supply that I would like to highlight: first, timber sales volume from National Forests in western Washington and western Oregon, and, second, the Canadian/U.S. currency exchange rate.

### 1. Timber Sales Volumes

As shown in figure 7, timber sales volume on National Forests in western Oregon and western Washington in the last half of 1988 and all of 1989 was considerably below the volume in 1987 and the first half of 1988. One result was a run-up in the average bid price to almost $400 per thousand board feet in the first quarter of 1990. These higher roundwood prices place producers in the Pacific Northwest at a competitive disadvantage relative to Canadian imports.

### 2. Canadian/U.S. Currency Exchange Rate

The last source of structural change that I want to highlight is the Canadian/U.S. currency exchange rate. As shown in figure 8, this exchange rate declined during the period that the Canadian market share was increasing. It bottomed out at about 70 cents in 1986 and increased steadily through 1990 to 85 cents Canadian per U.S. dollar. This increase in the relative value of the Canadian dollar was a factor in the fall in Canadian market share.

## Effects on Lumber and Stumpage Markets

The shifts in demands and supplies as well as the Memorandum of Understanding have interacted to determine markets for timber products since the agreement was signed. I would like to highlight the effects of these interactions on several measures of lumber and stumpage markets.

## Softwood Lumber Prices

After the Memorandum of Understanding was signed, softwood lumber prices increased. As shown in Figure 9, prices for southern pine, fir, larch, and Douglas-fir stud lumber increased over the period 1986 to 1989. Prices declined between 1989 and 1990, but remained above their 1986 levels due to the wood products demand for residential upkeep and improvement. Weakness in the U.S. housing market has significantly contributed to the recent price decline.

Prices for Canadian softwood lumber followed the same trend. Spruce-pine-fir stud lumber prices increased from 1986 to 1989, and then declined in 1990.

## Softwood Lumber Production

After the Memorandum of Understanding was signed at the end of 1986, softwood lumber production initially increased in all regions of the United States. As shown in Figure 10, production generally declined after 1987, especially in the Pacific Northwest Coastal Region. The decline in this region was likely due in part to weakness in the U.S. housing market and higher timber prices in the region.

## Employment in Production of Lumber

As shown in figure 11, employment in sawmills in the United States also increased following the signing of the Memorandum of Understanding. Employment rose from 141 thousand employees in 1986 to 152 thousand employees in 1988. In 1990, employment remained above 1986 levels, at 148 thousand employees. Declines since 1988 are due, in part, to a weakness in the residential housing market in the United States.

## Stumpage Prices

As shown in figures 12 and 13, the replacement measures put in place as a result of the Memorandum of Understanding have had significant impacts on the prices paid for stumpage by industry in British Columbia. The average price paid for stumpage doubled in the coastal region of the Province. In the Interior region, stumpage prices increased by a factor of five.

As shown in figure 14, average prices for softwood sawtimber increased after the Memorandum of Understanding was signed.

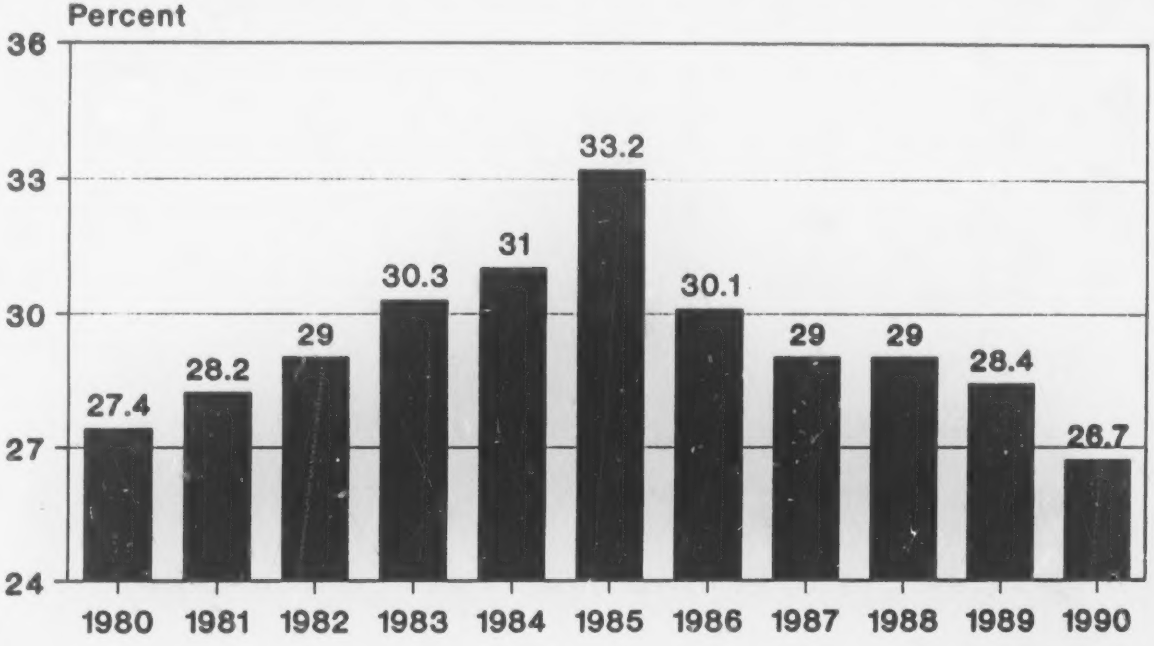
## Summary

The 1986 U.S.-Canada Memorandum of Understanding on Softwood Lumber was an important factor in determining U.S.-Canadian market interactions during the period, 1987 through 1990. However, there were many structural shifts that masked the direct effects of the agreement. The downturn in U.S. housing, increases in U.S. exports, the decline in timber sales volume in Oregon and Washington, and the exchange rate were some important factors. Canada's share of the U.S. softwood lumber market has declined since the signing of the Memorandum of Understanding. U.S. softwood lumber prices, production, and employment and stumpage prices all increased following the signing of the agreement. Stumpage prices in British Columbia at least doubled after implementation of replacement measures.

This completes my testimony. I will be pleased to answer your questions or provide additional information.

Figure 1

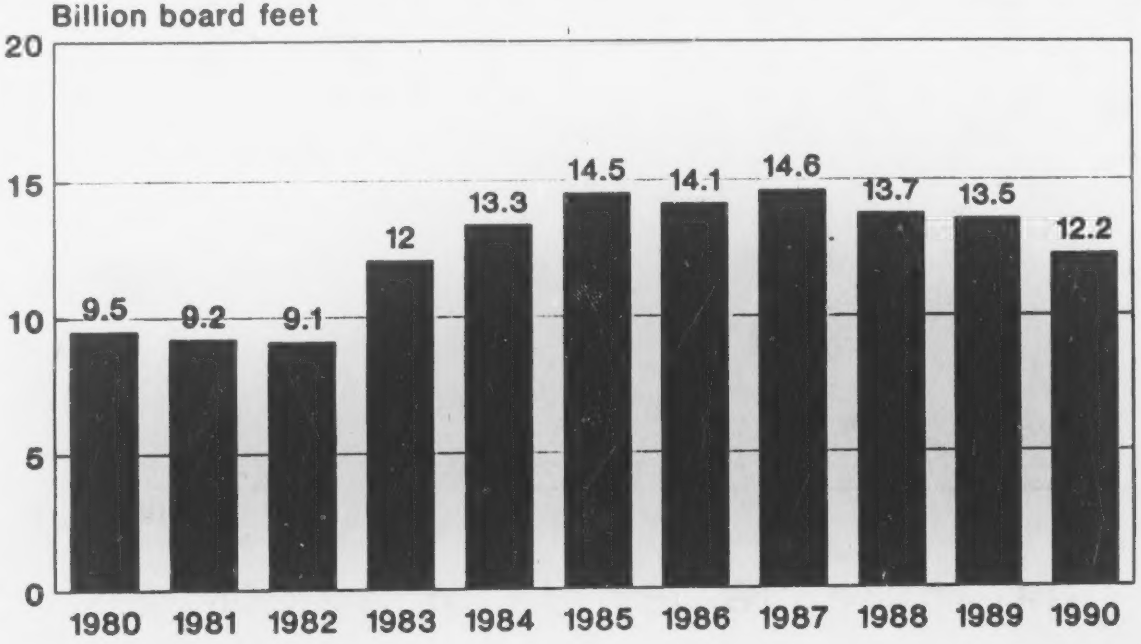
Canadian Share of United States Softwood Lumber Market, 1980-1990



1990 data
through October

Figure 2

## United States Softwood Lumber Imports from Canada, 1980-1990



1990 Based
on Jan-Oct

Figure 3

United States Housing Starts
1980-1990

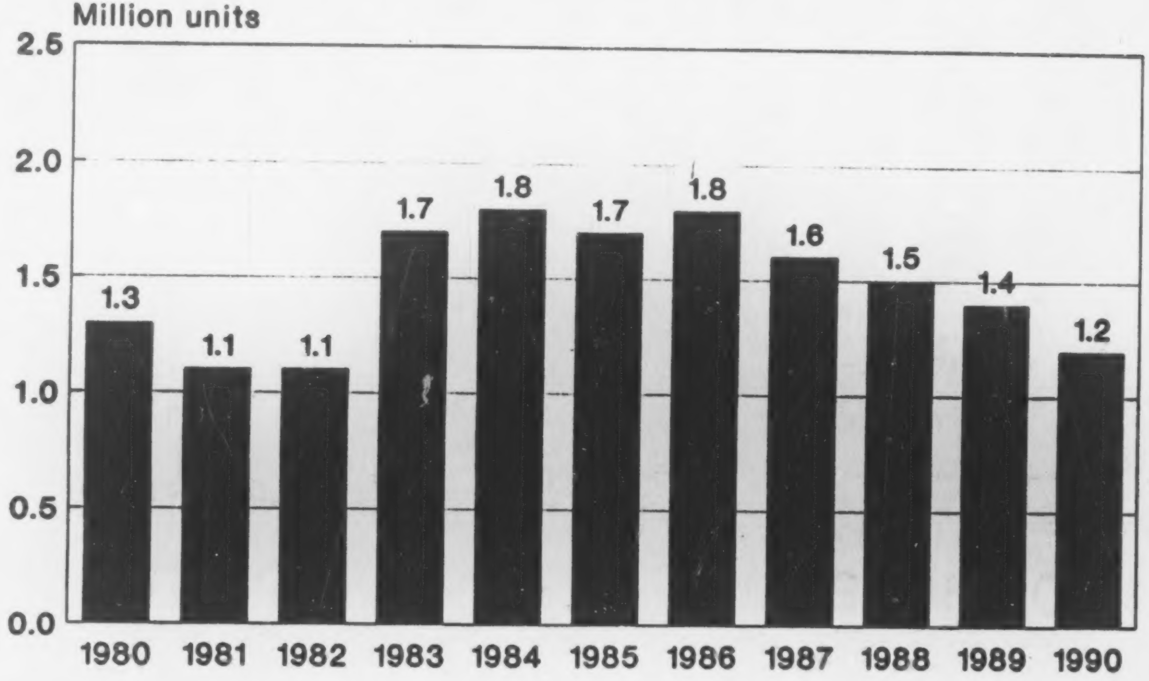
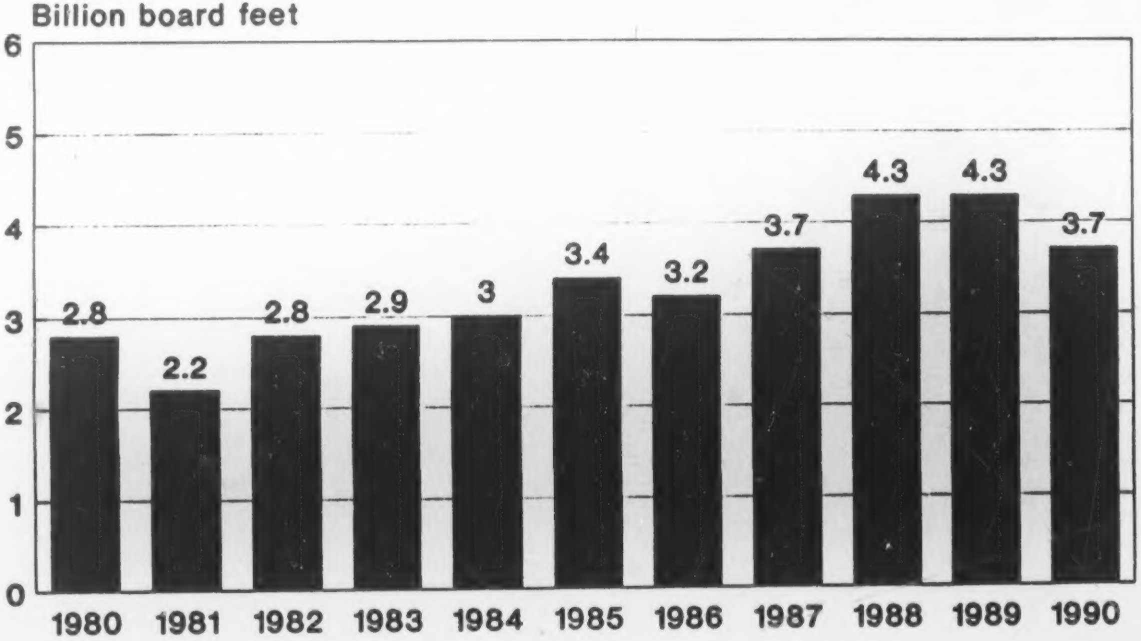


Figure 4

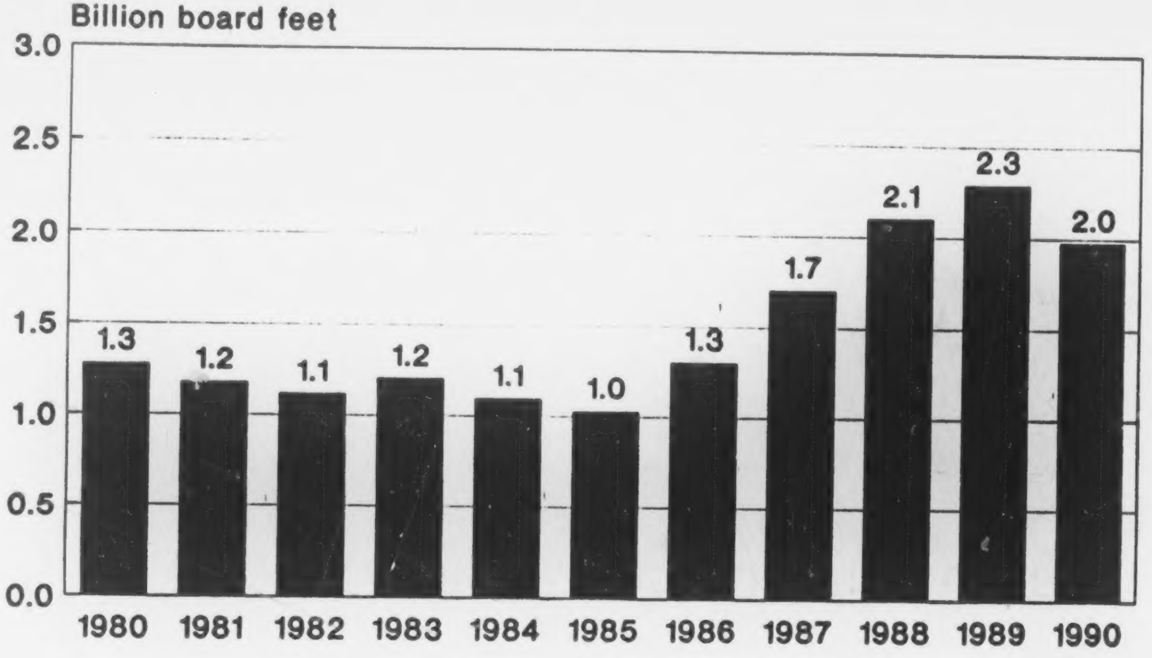
United States Softwood Log Exports from Pacific Coast Ports, 1980-1990



1990 based on Jan-Nov

Figure 5

United States Softwood Lumber Exports from Pacific Coast Ports, 1980-1990



1990 based
on Jan-Oct

Figure 6

## United States Gross National Product Seasonally Adjusted Annual Rate

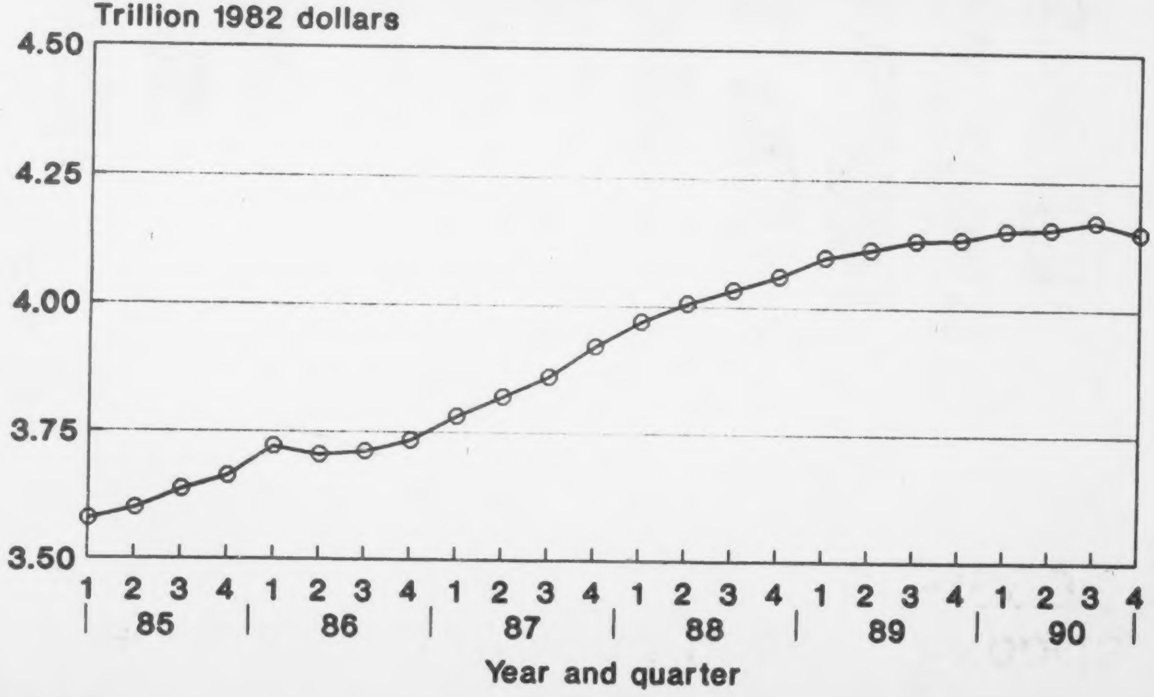


Figure 7

Volume and Price Forest Service Timber Sales in Western Washington and Oregon

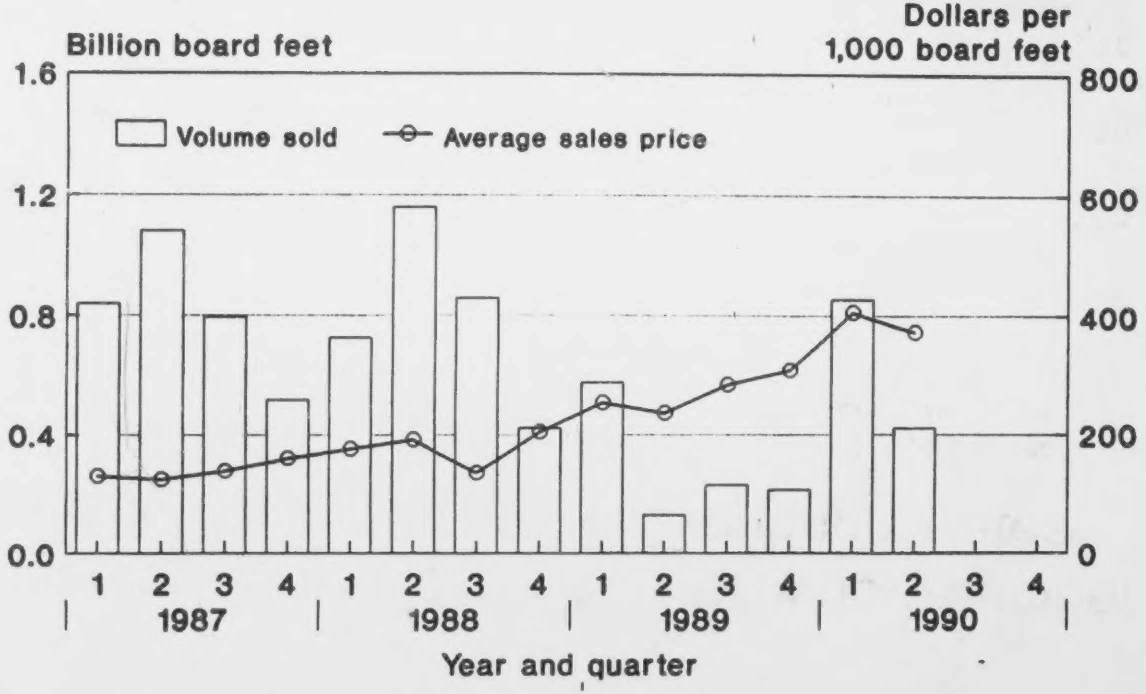


Figure 8

## Canadian Share of U. S. Softwood Lumber Market and Currency Exchange Rates

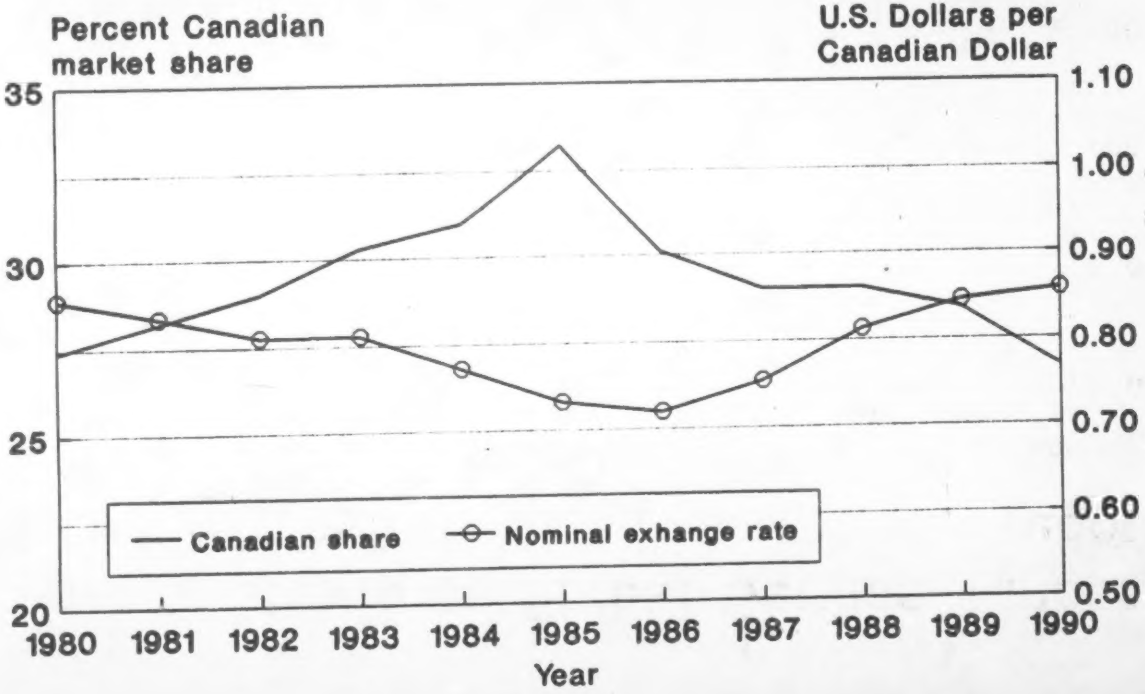


Figure 9

# Western Softwood Lumber Prices
# 1980-1990

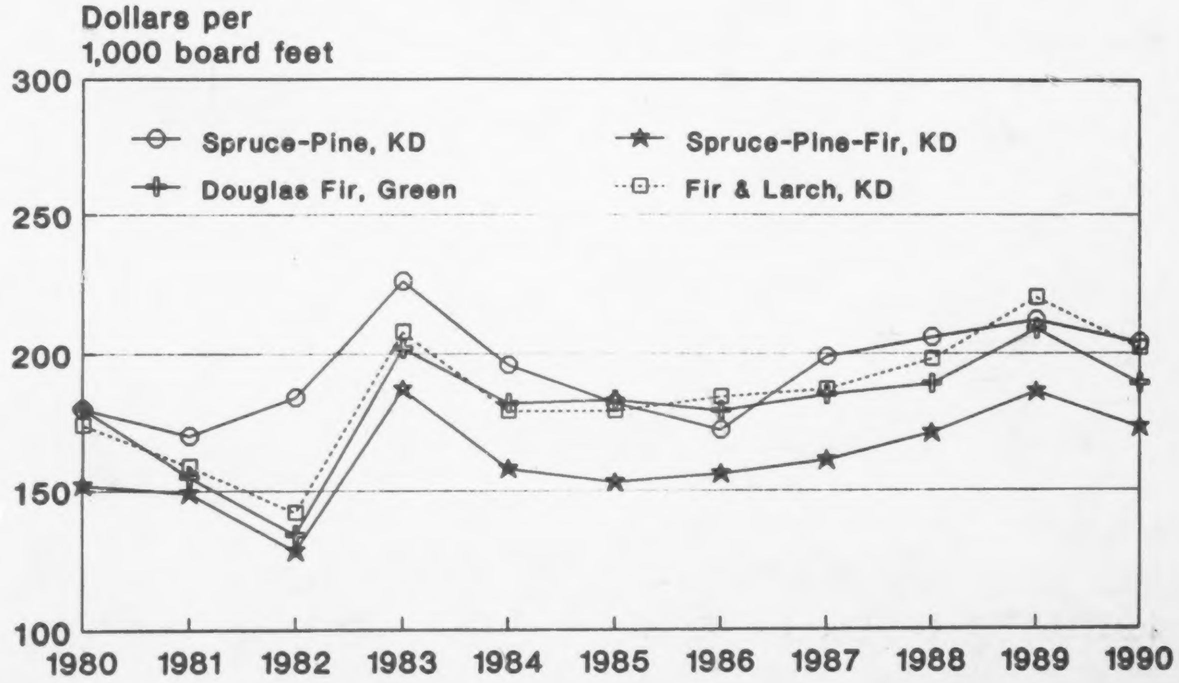
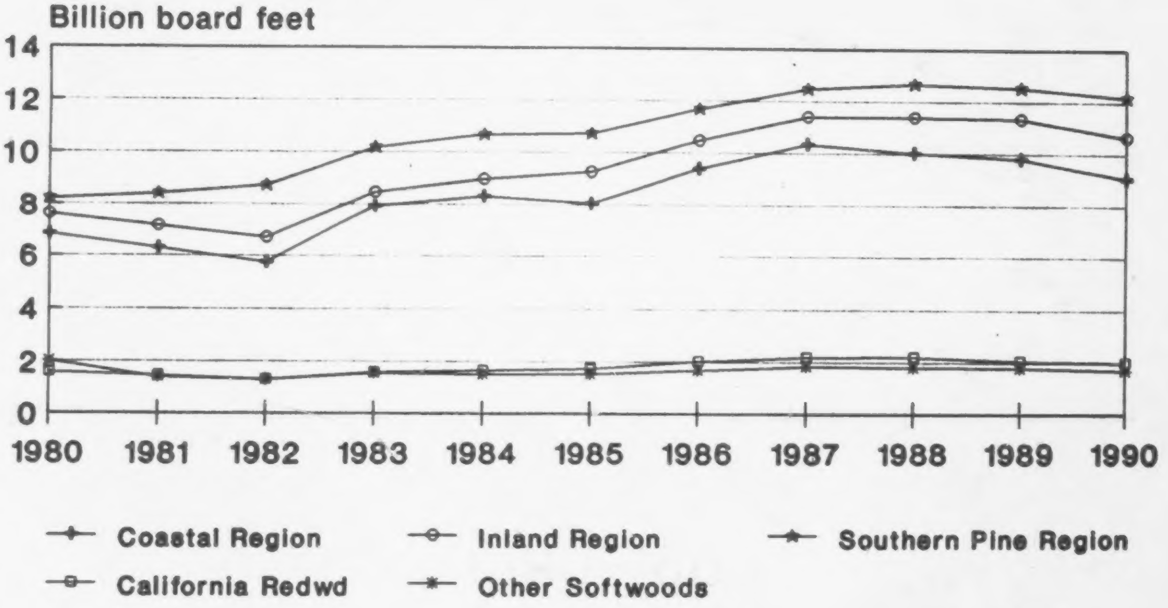


Figure 10

## United States Regional Softwood Lumber Production, 1980-1990



1990 estimates
based on Jan-Oct

Figure 11

## Employment in United States Sawmills and Planing Mills, 1980-1990

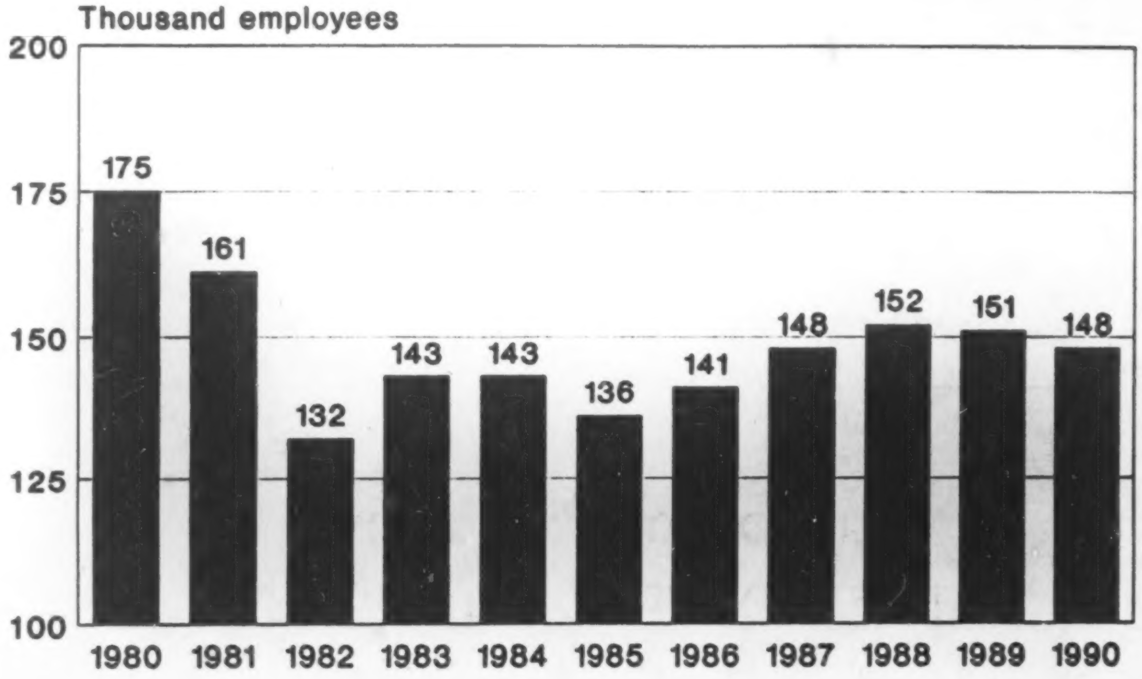


Figure 12

## British Columbia Coastal Stumpage Collections

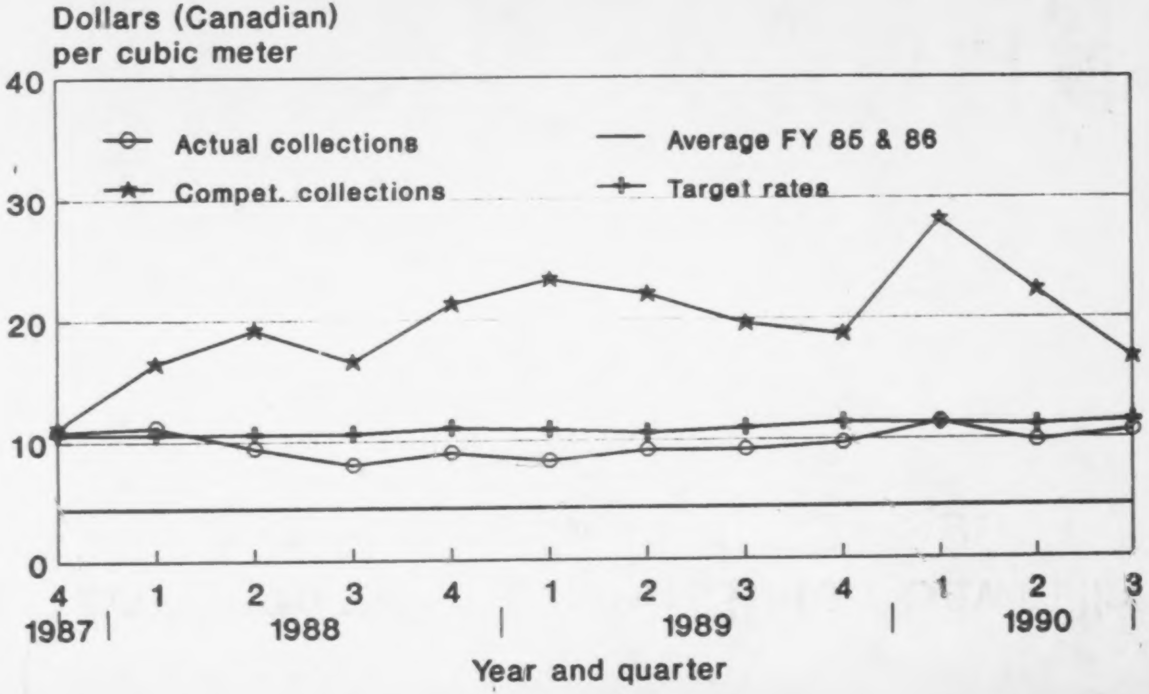


Figure 13

## British Columbia Interior Stumpage Collections

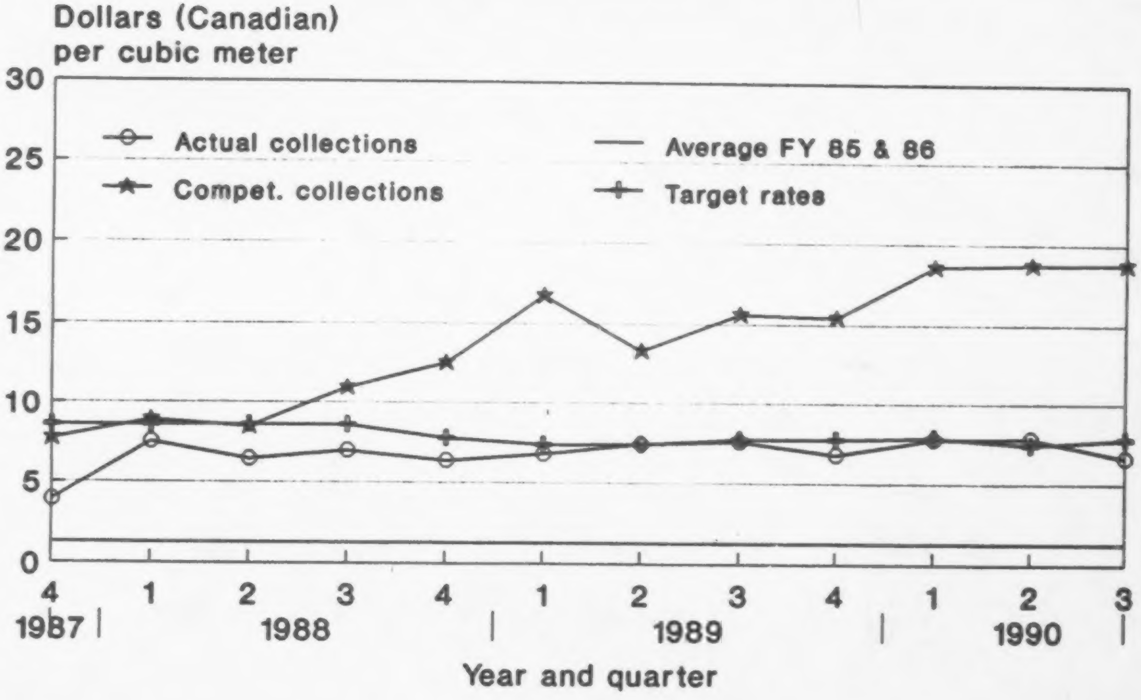
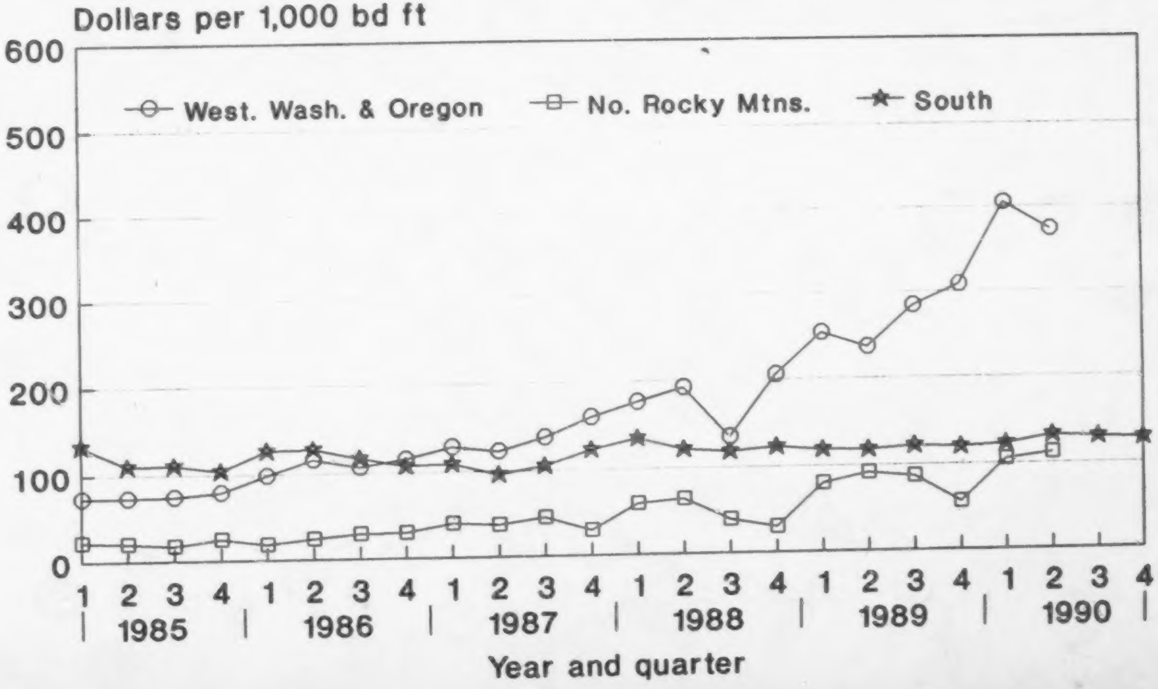


Figure 14

## Western and Southern Softwood Sawtimber Stumpage Prices



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202-225-7797

PAUL [illegible]
MINORITY SUBCOMMITTEE PROFESSIONAL
STAFF MEMBER
202-225-[illegible]

February 10, 1991

TO: Ron Wyden, Chairman

Subcommittee on Regulation, Business Opportunities and Energy

FROM: Subcommittee Staff

SUBJECT: Dumping of Canadian Lumber in U.S. Markets:

Is the 1986 U.S.-Canada Memorandum of Understanding on Softwood Lumber Imports Protecting U.S. Manufacturers Against Subsidized Canadian Products?

Will the Canadians Abrogate the Agreement?

What Would be the Likely Effect on U.S. Timber Manufacturers and Employment?

How Will U.S. Government Officials Respond?

## INTRODUCTION

At the Chairman's request, subcommittee staff are conducting an inquiry into the enforcement, performance and future of the U.S.-Canada Memorandum of Understanding on Softwood Lumber -- an agreement designed to protect U.S. timber product manufacturers against competition from highly government subsidized Canadian lumber exports.

The basis for this inquiry is as follows:

1. The agreement, now in its fifth year of enforcement, is one of the few pre-existing treaties with Canada "grand-fathered" into the 1988 Free Trade Agreement rather than eliminated, outright, by the omnibus treaty. As the agreement includes a controversial export tax of up to 15 percent on Canadian lumber shipped to the United States, this is an appropriate time to assess what adjustments, if any, are needed.

2. Although the performance of the agreement is generally given strong reviews by U.S. timber product manufacturers (they say it has saved jobs and mills, and reduced Canadian market share in the U.S.), western Canadian timber companies are highly critical of the agreement on several points. They are pressuring their political leaders to abrogate the agreement.

3. Canadian provincial and federal officials, including senior members of the Mulroney cabinet, have stated publicly that they plan to abrogate the agreement in the near future. U.S. wood product companies already hammered by low domestic lumber demands fear that substantial mitigation or elimination of the agreement will lead to a new round of subsidized Canadian wood products dumping, resulting in substantial U.S. mill closures and sector-wide unemployment.

In short, the western Canadian provinces and the Canadian federal government have never liked the agreement.

Declines in the North American timber market adversely effecting manufacturers in both nations have encouraged a new round of demands on the Canadian government to abrogate the agreement.

> According to public statements by Canadian government officials, and private communications by Canadian industry representatives to subcommittee staff, the formal and unilateral repudiation of this agreement by officials of the Canadian federal government can be expected, shortly.

At the Chairman's direction, an oversight hearing on these matters is planned for Friday, February 22, 1991. Testimony is expected from (1) U.S. Commerce Department officials charged with enforcing the agreement, (2) Canadian provincial government officials who have called for abrogation of the agreement, (3) U.S. and Canadian wood product manufacturers and (4) timber market analysts.

In effect, this agreement was designed to partially off-set stumpage rates -- the price Canadian manufacturers paid for standing, government-owned timber. Canadian "Crown" stumpage was, and in some cases continues to be, dramatically below "market" rates paid by U.S. timber companies buying trees through competitive bidding.

> Evidence suggests that the price differential may be as high as 10x.

This subsidy, which has existed for several decades, has allowed Canadian manufacturers in recent years to capture up to one-third of the U.S. domestic market. In the period of fastest growth during the 1970s and early 1980s, the burgeoning Canadian share of the U.S. market helped close hundreds of U.S. wood product mills in the Pacific Northwest and the Southeast, and spelled job losses for tens of thousands of U.S. timber workers.

Known generically as the MOU, the agreement resulted in an export tax of up to 15 percent assessed by Canadian provincial governments against shipments of finished forest products to the United States. As some provinces increase stumpage rates on public timber, the export tax has been proportionately reduced.

Hearing witnesses will be asked to comment on, or add to preliminary staff findings.

## FINDINGS

1. Although the presence and/or level of subsidization of government owned Canadian timber is disputed by Canadian officials and timber companies, there is substantial evidence that not only did heavy subsidization exist prior to the agreement -- heavy subsidization exists today.

2. This subsidization is likely to continue as long as Canadians sell public timber without benefit of competitive bidding by purchasers.

3. This subsidy has had a dramatic impact on the U.S. lumber market. In the three decades between the early 1950s and the early 1980s, for example, the Canadian share of the U.S. market rose from the low single digits to more than 30 percent.

4. Since imposition of the export fee in 1986, however, Canadian penetration of the U.S. lumber market has fallen from a high of 33.2 percent to 26.7 percent in 1990 (see attached chart). U.S. mills have been economically strengthened. Importantly, there has been no identifiably adverse impact on Canadian timber product manufacturers. While their rapid growth (thanks to exploding U.S. market demands in the mid-1980s) has tailed off, Canadians cannot argue that the agreement has lead to economic recession within their industry.

> -- Canadian lumber production rose from 14.9 billion board feet in 1976 to 22.3 billion board feet in 1985, the salad days of the pre-1986 agreement period. U.S. production increased from 29.7 billion board feet to 30.6 billion during the same period.

-- During approximately the same period, the U.S. industry closed 629 mills and reduced overall employment by 30,000 jobs.

-- While the Canadian share of the U.S. market has declined, Canadian shipments to the U.S. remain substantial. In 1989, for example, shipments were higher than in any year since the peak share year of 1985. In the years 1987 and 1988, timber companies in British Columbia, Canada's number one timber-producing province, reported higher earnings and profits than in any year between 1974 and 1985.

5. Although the export tax has not fully compensated for the high degree of Canadian stumpage subsidization, Canadian provinces have collected hundreds of millions of dollars in annual revenues from the provision. And, among other benefits, these revenues have encouraged the provincial governments to improve public forest management practices including substantial increases in reforestation efforts.

-- British Columbia stumpage rates have risen significantly, and the export fee in that province has been dropped to zero. As stumpage has increased, so has the level of utilization of harvested timber and the elimination of harvest wastage.

(Other provinces may not have followed suit. The export fee remains at the full 15 percent in Saskatchewan, Alberta, Manitoba and Ontario. The export tax has been reduced in Quebec.)

## THE FEDERAL AGENCY POSITION

The 1986 MOU was enacted following a formal finding by the U.S. government that the Canada provinces and federal government were subsidizing exports of finished lumber to the United States by vastly under-pricing public timber.

Over a ten-year period ending in the mid-1980s, Canadian market share in the United States nearly doubled. The U.S. government, spurred by industry complaints, found that Canadians had breeched anit-dumping laws, and on that basis threatened to levy a countervailing duty against Canadian exports to the United States.

The Memorandum of Understanding was seen in part as a settlement of that trade complaint. In return for imposition of an export fee charged by Canadian provinces against lumber exports to the United States, the United States would withhold the duty.

Since 95 percent of all timber in Canada is government owned, and since 90 percent of all timber sales are without benefit of competitive bidding, the MOU applies to virtually all timber products shipped from Canada to the United States.

Changes in the export fee by provinces are subject to conferral with the U.S. government. This is the heart of a primary Canadian complaint -- that the MOU embodies an obnoxious loss of sovereignty. Coupled with a continuing recession in the North American wood products industry, the sovereignty complaint generates significant political problems for the Canadian federal government and Prime Minister Mulroney.

> Minister of External Affairs Joe Clark has informed the Parliament that he will work for a renegotiation of the agreement. Trade Minister John Crosbie also has publicly called for an end to the MOU.

The MOU's opponents point out that the largest lumber exporter, British Columbia, now operates at a zero export tax level thanks to increases in stumpage.

But U.S. manufacturers argue that without the MOU -- and the ancillary commitment by the Reagan Administration to pursue trade sanctions against Canada if Canada fails to comply with rules of the agreement -- domestic manufacturers are threatened with a potential new round of dumping of heavily subsidized Canadian forest products in U.S. markets.

> This concern is fueled in part by calls from officials of the British Columbia provincial government and the BC forest industries to repudiate the MOU so that the province may be able to cut its stumpage rates to pre-1986 levels.

The movement within Canada to abrogate the agreement has caused considerable unease in the U.S. forest products industry. M.J. "Gus" Kuehne, president of the Northwest Independent Forest Manufacturers of southwestern Washington state, reflects the mood in a recent statement to the subcommittee:

> "...as bad as conditions are currently, they would be much worse if the U.S.-Canadian MOU did not exist and Canada could insulate itself from the current recession by simply reducing stumpage rates to virtually zero, thereby allowing them to operate at near-capacity,

> while U.S. mills suffer the market decline unilaterally."

This concern also has been the basis for correspondence between the Chairman and U.S. government officials (see attachments).

Questions raised with federal officials generally involve (1) alleged Canadian breeches of the agreement, (2) possible loss of U.S. enforcement ability through relinquishment of section 301 powers and (3) the willingness by our government to oppose a unilateral abrogation of the agreement by the Canadians.

In general, responses by various Administration officials indicate strong and consistent support for the spirit and content of the MOU, and for the ancillary support mechanisms which may be needed to keep the MOU in effect.

An excerpt from a January 18, 1991, letter from Commerce Secretary Robert A. Mosbacher is fairly typical:

> "Events in Canada suggest that the Government of Canada may be under increasing pressure to renegotiate, or eliminate, the Memorandum of Understanding. While the Canadian Government has tested our support for the MOU, it has not proposed specific changes to it.
>
> "We are firmly committed to the MOU and will take any action necessary and appropriate to enforce the terms of the agreement. Many of the underlying problems addressed by the MOU could be eliminated if Canada were to change from administratively determined timber prices to prices set by free market competition. To date, we have not seen any evidence of such structural changes in Canada that might eliminate the need for the MOU."

[illegible]
3D DISTRICT OREGON

[illegible]
SUITE 1406
LONGWORTH HOUSE OFFICE BUILDING
PHONE 202-225-4811

[illegible]
500 NE MULTNOMAH SUITE 250
PORTLAND OR 97232
PHONE 503-231-2300

Congress of the United States
HOUSE OF REPRESENTATIVES
WASHINGTON DC 20515

ENERGY AND COMMERCE

SMALL BUSINESS

SELECT COMMITTEE ON
AGING

July 7, 1988

The Honorable C. William Verity
Secretary
U.S. Department of Commerce
600 17th Street, N.W.
Washington, D.C. 20506

Dear Mr. Secretary:

We are writing to express our concern about apparent breaches of the 1986 U.S-Canada Softwood Lumber Agreement by the provincial government of British Columbia, and to urge aggressive action by your office in redressing this problem.

As co-chairmen of the Forestry 2000 Task Force, we believe our concerns are shared by many of the 116 Members of Congress involved in our organization.

The actions, cumulatively, represent little more than the renewal of obnoxious government subsidization of the Canadian timber industry as it attempts to increase its already large share of U.S. markets.

Our concerns focus on (1) the outright reduction of stumpage prices on interior British Columbia timber, (2) the announcement that these reductions will be retroactive to January 1, 1988, and (3) a decision by the British Columbia government to withhold re-indexing of stumpage prices as specified in the 1987 amendment to the softwood agreement.

Cumulatively, these changes could result in direct subsidies of more than $100 million to the Canadian wood products manufacturers. Additionally, we also are concerned that British Columbia and Canadian officials have been lax in providing lumber production and stumpage pricing data as called for in the agreement.

Before 1987, subsidized Canadian lumber imports were capturing an ever-increasing share of U.S. sales. The U.S. industry was being severely injured by these predatory tactics. Hundreds of mills were shutdown, and tens of thousand of workers lost their jobs while the Canadians opened new, government subsidized mills.

After the U.S. industry had received an affirmative preliminary countervailing duty decision, negotiators for the U.S. and Canada agreed that Canada would impose a 15 percent export charge on its lumber products shipped to the U.S. The charge was to offset Canadian lumber subsidies on stumpage. This agreement has been a critical element in the U.S. industry's rebound.

We are quite concerned, therefore, about recent breaches by British Columbia. If they are allowed to stand, the result could reverse the positive trends our industry now enjoys. Most certainly, these changes erode the good efforts by parties on both sides of the border to encourage free and unfettered trade in wood products within North American markets.

With action on the proposed U.S-Canada Free Trade Agreement approaching, it is particularly important to demonstrate that the United States will fully enforce our rights under existing international agreements. We understand your office will aggressively pursue these softwood agreement violations, and we applaud and support your strong position.

We in Congress are prepared to offer whatever assistance we can to ensure that the softwood agreement is enforced. It was necessary and justified when it was signed. It remains fully necessary and justified, today.

Thank you, again, for your attention to these issues.

Sincerely,

Ron Wyden
RON WYDEN
Member of Congress

Sid Morrison
SID MORRISON
Member of Congress

Lindsay Thomas
LINDSAY THOMAS
Member of Congress

Sonny Callahan
SONNY CALLAHAN
Member of Congress

THE UNITED STATES TRADE REPRESENTATIVE
Executive Office of the President
Washington, D.C. 20506

AUGUST 5 1988

The Honorable Ron Wyden
U.S. House of Representatives
Washington, D.C. 20515

Dear Ron:

Thank you for your letter on behalf of the Congressional Forestry 2000 Task Force regarding the U.S.-Canada Softwood Lumber Agreement.

We much appreciate your support on this issue. The agreement has contributed significantly to the strong recovery of the U.S. lumber industry, and has helped stabilize North American lumber trade. We are committed to the intent and substance agreement and to the full enforcement of U.S. rights. I believe that the Government of Canada is equally committed to fulfilling its obligations under the agreement.

We have expressed our serious concern to the Canadian Government regarding recent actions by the Province of British Columbia. As a result of those actions, in conjunction with the Department of Commerce, we initiated consultations with the Government of Canada several weeks ago. The discussions are scheduled to resume next week in British Columbia.

Both the U.S. and Canada have a common interest in ensuring that the agreement is fully implemented, and we therefore have every reason to expect that these issues can be satisfactorily addressed.

We look forward to working closely with you and other members of the Task Force on this issue, which is obviously of great interest to you and your constituents.

Sincerely,

Clay for
Clayton Yeutter
by [illegible]
acting

CY:wm

UNITED STATES DEPARTMENT OF COMMERCE
International Trade Administration
Washington, D.C. 20230

ASSISTANT SECRETARY FOR IMPORT ADMINISTRATION

Honorable Ron Wyden
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Wyden:

Thank you for contacting us again regarding the U.S.-Canada Memorandum of Understanding (MOU) on softwood lumber trade.

We too are concerned with Canadian compliance with the MOU. The agreement has been beneficial to the U.S. lumber industry, and we are firm in our commitment to uphold its terms.

We are investigating the changes in Canadian rail rates on lumber shipments to the U.S. We have asked the Government of Canada to provide us with an explanation of the reduction in order that we can evaluate the possible impact on the MOU.

As you indicated in your letter, there have been changes in forestry pricing and management practices in British Columbia. In conjunction with the Office of the United States Trade Representative, we have entered into consultations with the Government of Canada to evaluate these changes. We have expressed to the Government of Canada the U.S. government's serious concern regarding the actions taken by the province. We have been in close contact with our industry and their representatives and expect that these issues will be resolved soon.

If you have any additional questions or concerns, please contact Sarah Hildebrand, Director, Office of Congressional Affairs, at (202) 377-3015, or me, at (202) 377-1780.

Sincerely,

Jan W. Mares

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19 SEP 1988

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3d District

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(202) 225-4811

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(503) 231-2300

Congress of the United States
House of Representatives

Subcommittees:
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Telecommunications and Finance
Oversight and Investigations

Small Business Committee
Chairman,
Subcommittee on Regulation,
Business Opportunities and Energy

Select Committee on Aging
Health and Long-Term Care
Subcommittee

Cochairman,
Forestry 2000 Task Force

October 11, 1990

The Honorable Robert Mosbacher
Secretary
U.S. Department of Commerce
600 17th Street, N.W.
Washington, D.C. 20506

Dear Mr. Secretary:

We urge you to exercise caution and restraint in response to recent proposals by Canadian officials to reduce their export tax on finished Canadian wood products to the United States from 8 percent to 1.9 percent.

It is the view of the U.S. wood product manufacturing industry that this proposal -- which could lead to importation of millions of dollars worth of heavily government subsidized Canadian lumber into our domestic market -- cannot be supported under the terms of the 1986 U.S.-Canada Memorandum of Understanding on Softwood Lumber.

As co-founders and co-chairmen of the Congressional Forestry 2000 Task Force, an organization of 131 members of Congress who share an interest in forestry issues, we have long held that our government must be strong and vigilant in its maintenance of the terms of this vital agreement. Without this protection against highly-subsidized Canadian products, our domestic manufacturers would continue to lose market share in the United States. Eventually, many could be driven from the business. Ultimately under this scenario, the U.S. consumer would pay the price in higher costs for products from sources then dominated by Canadian suppliers.

We point out that the countervailing duty on Canadian imports to the United States was enacted only after hundreds of U.S. mills were shut down, at the loss of tens of thousands of jobs, primarily due to heavily subsidized Canadian expansionism in the 1970s and 1980s. The MOU was a marked trade success in that it stopped this accelerating erosion of a primary U.S. industry.

Therefore, we are extremely concerned about recent comments by several Canadian government officials -- Trade Minister Crosbie, External Affairs Minister Clark and Forests Minister Oberle--calling for renegotiation and elimination of the MOU.

These officials may argue that some provinces, in particular British Columbia, have increased stumpage fees to a near-marketplace level. However, Canadian timber by-and-large is still heavily subsidized. These stumpage advantages give Canadian wood product manufacturers a significant, continuing price advantage over U.S. competitors.

In short, great care must be taken to sustain the softwood agreement in the Uruguay Round of the General Agreement on Tariffs and Trade, in the enforcement of provisions _and exclusions_ of the U.S.-Canada Free Trade Agreement, and in the maintenance of the provisions of the MOU.

We must be especially careful in assessment of the Quebec proposal to reduce the export tax to 1.9 percent. We do not believe that Quebec's data and methodology support this _80 percent reduction_ -- or, indeed, any reduction in the current 8 percent fee. Regarding tax rate adjustments in the MOU, Quebec has consistently provided information months behind schedule. Volumes of information called for in the April 1, 1988, amendment to the MOU, for example, have never been provided.

Much "evidence" provided by the Canadians arguing that stumpage fees actually have been increased is highly suspect. For example, are we to accept the Canadian contention that fines levied against Canadian loggers for poor forest practices are equivalent to an increase in stumpage rates?

It seems plain to us that a fine is a fine, and a rate is a rate.

It also seems plain that we cannot accept a key element in the Canadian case for tax reduction, their _projection_ that stumpage fees are likely to increase sharply after three years of flat-line rates.

Mr. Secretary, our government cannot allow unilateral departures from the MOU. We must force the Canadians to prove their case for lower rates. We must also enforce the data reporting provisions of the MOU and its amendments. Loosening the present constraints of the MOU, or abandoning that agreement, altogether, without mandating market rates on Canadian stumpage, would cost our domestic suppliers hundreds of millions of dollars per year in lost sales.

We are prepared to offer whatever assistance we can to ensure that the softwood lumber agreement is enforced. It was necessary and justified when it was signed four years ago. It remains a crucial element of this nation's fair trade policy, today.

The Hon. Robert Mosbacher
Page Three

Thank you for your attention to this matter.

Sincerely,

Sid Morrison
SID MORRISON
Member of Congress

Sonny Callahan
SONNY CALLAHAN
Member of Congress

LINDSAY THOMAS
Member of Congress

RON WYDEN
Member of Congress

cc. Mr. Joseph A. Spetrini
Dep. Asst. Secretary for Compliance

**THE SECRETARY OF COMMERCE**
Washington, D.C. 20230

Honorable Ron Wyden
House of Representatives
Washington, D.C. 20515

November 1, 1990

Dear Ron,

Thank you for your cosigned letter regarding the U.S.-Canada memorandum of understanding (MOU) on softwood lumber and your concern over the Government of Quebec's proposal to lower the export tax on lumber shipments from Quebec.

Events in Canada suggest that the Government of Canada may be under increasing pressure to renegotiate, or eliminate, the MOU. Some mill closures, a stronger Canadian dollar, and fear of a market downturn have made the agreement a political target. While Canada has tested our support for the MOU, it has not proposed specific changes to it.

We are firmly committed to the MOU and will take any action necessary and appropriate to enforce the terms of the agreement. Although Canada's larger economic problems have an impact on the lumber industry, they do not affect the subsidies which the MOU offsets. Many of the underlying problems addressed by the MOU could be eliminated if Canada were to change from administratively determined timber prices to prices set by free market competition. To date, we have not seen any evidence of such structural changes in Canada that might eliminate the need for the MOU.

The MOU allows provinces to eliminate or reduce the 15 percent export tax through "replacement measures" that raise the amount charged to harvest public timber in a given province. In 1988, the export tax on shipments from Quebec was lowered to 8 percent following new cost increases imposed on its lumber industry. This replacement measure expires on October 31, 1990, and the Government of Quebec has proposed that the export tax on shipments from Quebec be lowered from the current 8 percent to 1.9 percent. We are studying Quebec's proposal carefully and will give your comments due consideration as we proceed with the renegotiation on the replacement measure.

If you have further questions, please contact Eric I. Garfinkel, Assistant Secretary for Import Administration, at (202) 377-1780, or the Office of the Assistant Secretary for Congressional and Intergovernmental Affairs, at (202) 377-3663.

Sincerely,

Robert A. Mosbacher

**RON WYDEN**
OREGON
3D DISTRICT

2452 RAYBURN BUILDING
WASHINGTON, DC 20515
(202) 225-4811

500 NE MULTNOMAH, SUITE 250
PORTLAND, OR 97232
(503) 231-2300

Congress of the United States
House of Representatives

ENERGY AND COMMERCE COMMITTEE
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SUBCOMMITTEE ON REGULATION,
BUSINESS OPPORTUNITIES AND ENERGY

SELECT COMMITTEE ON AGING
HEALTH AND LONG-TERM CARE
SUBCOMMITTEE

CO-CHAIRMAN,
FORESTRY 2000 TASK FORCE

October 25, 1990

The Honorable George Bush
President
The United States of America
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear Mr. President:

On or before November 15, 1990, our negotiators must submit their final package of positions on all items to be addressed in the Uruguay Round of the General Agreement on Tariffs and Trade. As co-chairmen of the Congressional Forestry 2000 Task Force, a bi-partisan organization of 131 members of Congress who share interests in public and private forestry, we urge you while determining that final package to consider several issues of crucial importance to our forest industries.

These issues strike at the heart of our industry's competitiveness in international markets, and can help maintain hard-won achievements which have contributed positively to our trade balance. They are:

1. The market-opening agreement struck with Japan last year under the so-called Super 301 provisions of the Trade Act anticipated significant Japanese tariff reductions in the current GATT process. We are informed that the Japanese -- despite their earlier acquiesence to this plan -- are now balking at rate reductions in the Uruguay Round. We believe in order to maintain the integrity of the earlier trade negotiation with Japan, and to give our industry fair access to Japanese markets, U.S. negotiators must hold firm to our earlier demands agreed to by the Japanese for tariff reductions in the GATT process.

The elimination of these high tariffs could have the effect of increasing U.S. wood products sales in Japan by hundreds of millions of dollars per year.

2. Our wood products industry supports the zero-for-zero approach to elimination of all tariffs, worldwide, on a reciprocal basis. We believe that if all wood product tariffs were eliminated, the U.S. wood products industry could see immediate sales gains, worldwide, of between $2 billion and $4 billion per year, with resulting industry employment increases of up to 40,000 new jobs.

3. U.S. negotiators must resist any efforts forcing us to recede from, or rescind bilateral fair trade negotiating tools contained in the Trade Act. Of particular and proven importance to the forest products industry are the Section 301 and Super 301 processes which have resulted in fair trade agreements with both Canada and Japan.

We believe these instruments will have continued importance in the years ahead. Their loss would jeopardize recent, crucial trade victories achieved by the industry. And in a world where some of our competitors maintain very high trade barriers to their own markets while demanding full access to U.S. consumers, it would be foolhardy to unilaterally disarm by diminishing or abandoning these fair trade tools.

Please be assured that in the weeks and months ahead we will support your efforts, and the efforts of our negotiators, to achieve an international fair-trade environment.

Sincerely,

Sonny Callahan
SONNY CALLAHAN
Member of Congress

Lindsay Thomas
LINDSAY THOMAS
Member of Congress

Ron Wyden
RON WYDEN
Member of Congress

Sid Morrison
SID MORRISON
Member of Congress

cc.

The Hon. Carla Hills, U.S. Trade Representative

DEPUTY UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON, D.C. 20506

DEC 26 1990

The Honorable Ron Wyden
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Wyden:

Thank you for the letter to the President from you and your co-chairmen on the Forestry 2000 Task Force regarding the wood products industry's Uruguay Round objectives. U.S. government negotiators have worked closely with industry representatives to develop positions in the Round which, I believe, reflect those enunciated in your letter. We are working hard to achieve those objectives during the course of the negotiations.

With respect to Uruguay Round tariff negotiations with Japan, we continue to press the Japanese government to reduce its tariffs on wood products to zero. The Japanese are aware of their June commitment to deal positively with forest products in the Round, and we expect that they will fully implement that commitment.

Regarding the future use of U.S. trade law to achieve reasonable, non-discriminatory trade treatment abroad, we would oppose any Uruguay Round agreement that would not enable us to achieve such treatment. While we support all countries' reaffirmation of their commitment to the use of GATT dispute settlement procedures, we do not intend to relinquish our rights to take other appropriate action when necessary.

We appreciate your support for our efforts in the Uruguay Round and beyond. I believe we have developed a good, cooperative working relationship among the Congress, the Executive Branch and the wood products industry which has served our interests and efforts well and, I am sure, will continue to do so.

Sincerely,

Julius L. Katz

JLK:bmb

OREGON
3D DISTRICT

2452 RAYBURN BUILDING
WASHINGTON, DC 20515
(202) 225-4811

NE MULTNOMAH, SUITE 250
PORTLAND, OR 97232
(503) 231-2300

Congress of the United States
House of Representatives

[illegible]
HEALTH AND THE ENVIRONMENT
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BUSINESS OPPORTUNITIES AND ENERGY

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HEALTH AND LONG-TERM CARE
SUBCOMMITTEE

CO-CHAIRMAN,
FORESTRY 2000 TASK FORCE

December 14, 1990

The Honorable Robert Mosbacher
Secretary
U.S. Department of Commerce

Ambassador Carla Hills
U.S. Trade Representative

Dear Mr. Secretary and Madam Ambassador:

I know we share a mutual frustration and discouragement at the apparent failure this month of the Uruguay Round of the General Agreement on Tariffs and Trade. Both of you worked long and hard to bring this four-year effort to a successful conclusion. Your strategy and goals were excellent, and I continue to support the negotiating positions you held throughout the discussions.

However, while I realize that there may be a slight chance to reopen these talks, the United States must begin plotting a trade bargaining plan for a future, post-Uruguay, Round. Since a broad, multilateral solution appears unattainable at this time, this plan must center on bilateral agendas -- or at most agreements between small blocks of trading partners. The proposed free trade agreement with Mexico is an excellent example of real progress which can be made outside of the GATT, multilateral format.

As you may know, I am particularly concerned with developing free and unsubsidized markets in finished forest products. U.S. wood product sales are being stymied by a variety of tariffs, unfair standard barriers, quotas, unscientific phyto-sanitary rules, and other trade obstacles. On tariffs alone, resulting lost opportunities involve close to $4 billion worldwide in unrealized annual sales, according to the National Forest Products Association.

Despite these problems, opportunities are close at hand to improve U.S. wood products trade through bilateral talks.

I write you today in order to detail for your consideration three high-priority problem areas for the U.S. wood products industry. I request that you provide me with (1) an update of our trade negotiations in each instance, and (2) a discussion of our goals, opportunities and general strategy in each case.

These Priorities, in their order of importance, are as follows:

-1- Realization of long-term goals to eliminate Japanese finished wood product tariffs. Perhaps no other single trade barrier reduction could mean so much to our industry. The NFPA indicates that elimination of tariffs in this country could produce better than $1 billion additional U.S. wood product sales per year. Our goal should be the absolute elimination of these tariffs. Further, we must attain the elimination of non-tariff barriers outlined within the 1990 Super 301 agreement.

-2- Maintenance of the 1986 Memorandum of Understanding provisions with Canada on softwood lumber. Canadian representatives have indicated to my office that Canada will shortly announce its unilateral abandonment of this agreement. Their decision could result in hundreds of millions of dollars per year in lost sales for our U.S. wood products manufacturers. Our negotiators must maintain a strong position in support of all aspects of the MOU unless or until the Canadians can prove beyond a shadow of a doubt that they have ended highly subsidized sales of public timber to Canadian wood product manufacturers.

-3- Reduction or elimination of non-tariff barriers and quotas in the European Common Market. Our manufacturers are faced with a variety of protectionist barriers on the European continent. For example, the EC has threatened to cut-off imports of "green," non-kiln-dried timber products -- much of it from the Pacific Northwest -- over a scientifically questionable argument that these products contain insect pests. Some EC nations impose quotas on plywood and other U.S. panel products, barriers which again have a direct and egregious impact on Northwest mills.

Again, I hope the GATT members may yet come to an agreement within the Uruguay Round discussions. Should this process finally fail, however, our government must aggressively pursue bilateral opportunities to reduce barriers to wood products sales.

Should you have any questions regarding my request, please don't hesitate to call me, or Steve Jenning of my staff at (202) 225-7797. Thank you, again, for your continuing attention to these matters.

Sincerely,

Ron Wyden
RON WYDEN
Member of Congress

**THE SECRETARY OF COMMERCE**
Washington, D.C. 20230

January 18, 1991

Honorable Ron Wyden
House of Representatives
Washington, D.C. 20515

Dear Mr. Wyden:

Thank you for your letter regarding the international trade negotiations which affect the wood products industry.

The United States remains committed to maintaining and strengthening the multilateral trading system and to bringing the Uruguay Round to a positive and timely conclusion. We endorse the proposal from GATT Director General Dunkel to work with the participants, especially the European Community, to narrow differences. When it is clear that a sound basis exists for successfully concluding the Round, the United States will return to the negotiating table.

Notwithstanding the ultimate success or failure of the GATT round, we will continue to pursue bilateral and multilateral efforts to encourage free and unsubsidized markets in finished forest products. The U.S.-Japan Wood Products Agreement is a matter of utmost importance to the Department. As part of this agreement, Japan agreed to certain tariff reductions. We are fully committed to ensuring that the Government of Japan lives up to the terms of the agreement, including that portion dealing with tariffs. The U.S. Government and the Japanese Government have agreed to hold regularly scheduled meetings to facilitate smooth implementation of the agreement. Several meetings have already occurred, and more are planned. To date, we have been satisfied with the Japanese Government's implementation of the agreement.

Events in Canada suggest that the Government of Canada may be under increasing pressure to renegotiate, or eliminate, the Memorandum of Understanding (MOU). While the Canadian Government has tested our support for the MOU, it has not proposed specific changes to it. We are firmly committed to the MOU and will take any action necessary and appropriate to enforce the terms of the agreement. Many of the underlying problems addressed by the MOU could be eliminated if Canada were to change from administratively determined timber prices to prices set by free market competition. To date, we have not seen any evidence of such structural changes in Canada that might eliminate the need for the MOU.

As part of our Uruguay Round market access request on wood products, we have asked the European Community (EC) to eliminate the plywood quota and also to eliminate several questionable phytosanitary practices, including the ban on green coniferous lumber. We believe that there is insufficient evidence to warrant the ban. The EC approved recently a one-year derogation which will allow U.S. mills, in lieu of kiln drying, to certify that their lumber is bark and grub hole free. A joint research program will be undertaken early this year to try to identify other alternatives to kiln drying since the EC has indicated that the current derogation will not be extended.

Thank you again for your letter. I hope this information is helpful.

Sincerely,

Robert A. Mosbacher

Province of
British Columbia

OFFICE OF THE
MINISTER

Ministry of
Forests

Parliament Buildings
Victoria
British Columbia
V8V 1X4

Congressman Ron Wyden
Chairman
Subcommittee on Regulation,
  Business Opportunities, and Energy
United States House of Representatives
  Committee on Small Business
Room 363, Rayburn House Office Building
Washington, DC 20515

Dear Congressman Wyden:

Thank you for your letter of February 11, 1991 outlining your plans for congressional hearings on the 1986 Memorandum of Understanding (MOU) on Softwood Lumber between our two countries.

I regret that I must decline your invitation to participate in these hearings on February 22, 1991.

While I would welcome an opportunity to discuss with you, and your colleagues individually, my perspective of the MOU, I do not believe that it would be appropriate for me to appear before a congressional hearing.

Nevertheless, thank you for your kind invitation to appear.

Yours truly,

Claude Richmond

Claude Richmond
Minister of Forests

Weldwood

Weldwood of Canada Limited
P.O. Box 2179, Vancouver, B.C. V6B 3V8

DATE: February 18, 1991

TO: The Hon. Ron Wyden FAX No. (202) 225-8941
COMPANY: U.S. House of Representatives

FROM: T. A. Buell

NO. OF PAGES (INCLUDING THIS COVER PAGE): 3

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**Canadian Forest Industries Council**
**Le Conseil canadien des industries forestières**
55, rue Metcalfe Street, Suite 1550, Ottawa, Canada, K1P 6L5 • Tel: 613-236-7221 Tlx: 053-3138
Fax: (613) 236-9911

Address reply to 1200 - 555 Burrard Street
Adresse-réponse Vancouver, B.C. V7X 1S7
Fax: (604) 687-4930

*18 February 1991*

*The Hon. Ron Wyden*
*Chairman, Sub-committee on*
*Regulation, Business Opportunities*
*and Energy*
*Committee on SmallBusiness*
*U.S. House of Representatives*
*R-363 Rayburn House Office Building*
*Washington D.C. 20515*
*U. S. A.*

*Dear Congressman Wyden:*

*Because of previous commitments I will not be able to appear at the Sub-committee on Regulation, Business Opportunities and Energy of the Committee on Small Business of the U.S. House of Representatives on 22 February 1991 at 10:00 a.m.*

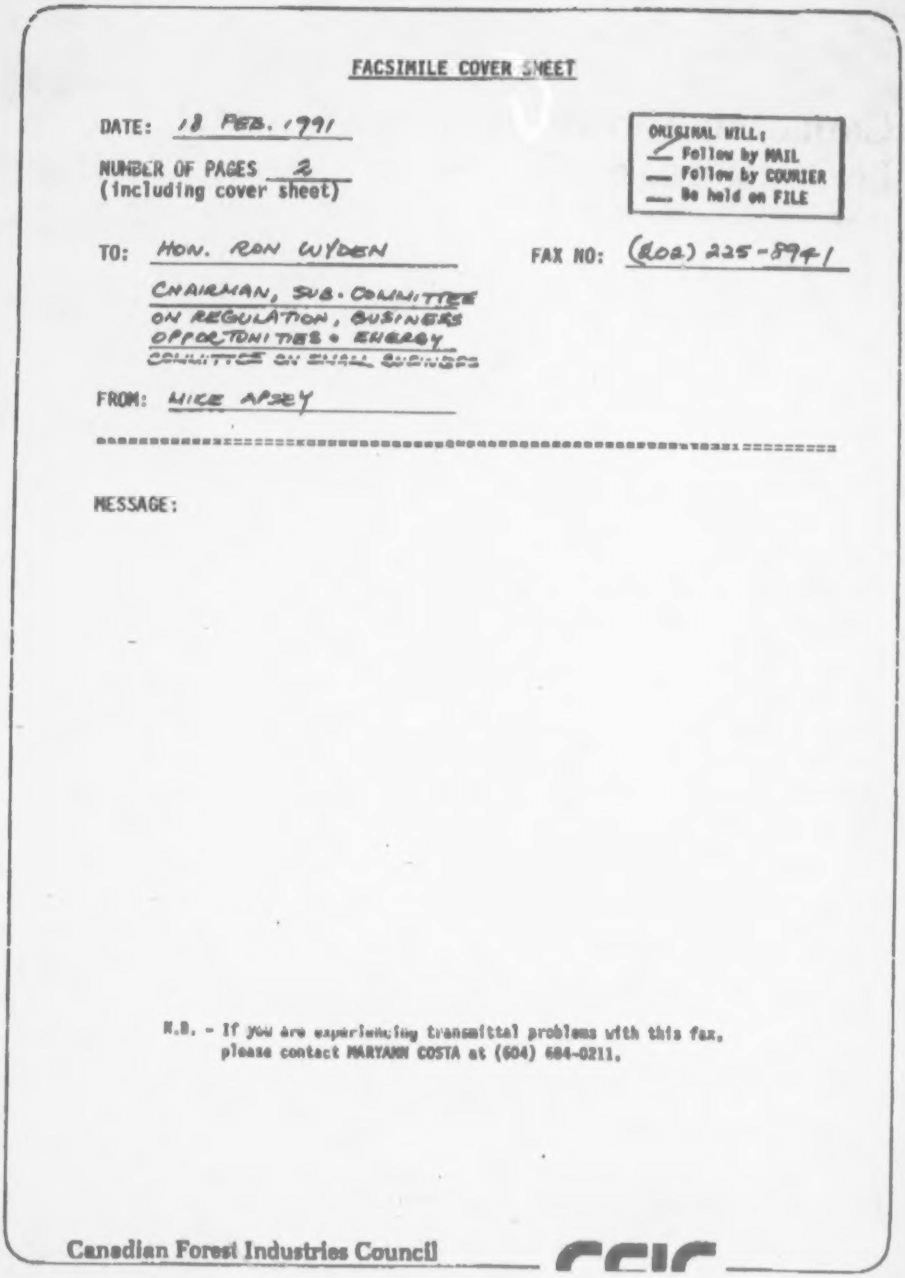
*I may, however, submit written testimony on behalf of the Canadian forest industry with attention to the questions you indicate in your letter that you intend to explore. If so, I will also take the opportunity to comment on other questions which may be raised by the testimony at the hearing.*

*Thank you for the kind invitation. I expect to be in Washington in the near future and I hope we can have a visit at that time.*

*Yours very truly*

T.M. Apsey

*T. M. Apsey*
*Trade Co-ordinator*



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DATE: 18 FEB. 1991

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TO: HON. RON WYDEN
CHAIRMAN, SUB-COMMITTEE
ON REGULATION, BUSINESS
OPPORTUNITIES & ENERGY
COMMITTEE ON SMALL BUSINESS

FAX NO: (202) 225-8941

FROM: MIKE APSEY

MESSAGE:

N.B. - If you are experiencing transmittal problems with this fax, please contact MARYANN COSTA at (604) 684-0211.

Canadian Forest Industries Council

**Canadian Forest Industries Council**
**Le Conseil canadien des industries forestières**
55, rue Metcalfe Street, Suite 1550, Ottawa, Canada, K1P 6L5 • Tel: 613-235-7221 Tlx: 053-3138
Fax: (613) 236-9911

Address reply to 1200 - 555 Burrard Street
Adresse-réponse Vancouver, B.C. V7X 1S7
Fax: (604) 687-4930

18 February 1991

The Hon. Ron Wyden
Chairman, Sub-committee on
Regulation, Business Opportunities
and Energy
Committee on Small Business
U.S. House of Representatives
R-363 Rayburn House Office Building
Washington D.C. 20515
U. S. A.

Dear Congressman Wyden:

It is with regret that I must advise you that I am unable to accept your invitation to appear and testify before the Sub-committee on Regulation, Business Opportunities and Energy of the Committee on Small Business of the U.S. House of Representatives on 22 February 1991 at 10:00 a.m. Previous commitments prohibit my travelling to Washington on that date.

Speaking for the Canadian Forest Industries Council (CFIC), I must say that we are pleased that the Congress is seeking the views of the Canadian parties most impacted by the 1986 U.S.-Canada Memorandum of Understanding on Softwood Lumber.

We are considering having Mr. Mike Apsey, CFIC's Trade Co-ordinator, submit a written response for the record and, if necessary, answer the questions you indicate you intend to explore at the hearing.

We note the position of the U.S. Coalition for Fair Lumber Imports that the Canadian lumber industry ". . . face the same economic recession problems now being experienced by U.S. lumber producers." But we take exception on several levels to the statement: "Because of the subsidies provided prior to the MOU, Canadian sawmills have never faced this situation". Such a statement is just plain wrong.

*I'm sorry I will not be able to attend your hearing but we welcome your effort to listen to all parties involved in the Memorandum of Understanding.*

*Yours very truly*

Buell

*T. A. Buell*
*Chairman*

JUN -5 1989

THE WEST

# A growing scaling scandal

*Auditors and police say timber stumpage rules are too vague to enforce*

LORI COHEN

**The B.C. forestry industry:** *Holes big enough to drive a logging truck through.*

At the heart of British Columbia's system for collecting stumpage on timber cut from crown forests is an arcane process, part art, part mathematics and part educated hunchwork, called "scaling." This is the valuation of the logs which the timber licensee uses to pay not only the B.C. government but the contractor who actually fells and delivers the wood to the mill. Since 1980 the government has gradually turned over scaling to the forest industry itself, laying off 400 scalers while maintaining a corporal's guard to perform spot checks on the private evaluators. Over the same period, due to American pressure to increase stumpage, revenues accruing to the government increased from $200 million to $600 million annually. Evidence is mounting that the system is now riddled with holes big enough to drive logging trucks through, with losses to B.C. of between $25 million and $100 million annually.

In March, Auditor-General George Morfitt told the government there was a "high risk" of stumpage being lost due to faulty scaling and delinquent reporting. And in late May the NDP opposition in the legislature brought to light a letter to David Parker, the minister of Forests, from the RCMP's Vancouver-based Log Theft Section claiming the police were unable to prosecute suspected scale fraud because the government's rules were so vague and inconsistently applied.

"Log Theft Section cannot pursue charges," complained Inspector E.B.M. Terkelsen, "as policies that were set up by Forestry were not followed through from the outset, thus eliminating any proof of intent to defraud Forestry of stumpage. Policy is not law and therefore no offence has been committed. These two incidents amount to $300,000 in unpaid stumpage, and they are by no means isolated incidents."

As the inspector explains it, the problem arose over two stands of crown-owned timber near Powell River and Campbell River, whose cutting rights were separately held, but which were actually cut and evaluated by the same contractor and scaler. While policy requires the scaler to hand his "scaling sheets" in immediately to the government, so that the owner of the cutting rights can be billed, the ministry in fact allows so many exceptions, according to the RCMP, that no case could be made against anyone for failing to hand in the sheets. It is possible to avoid payment for several months or, potentially, forever.

Those who are billed but don't pay can also make a mockery of government regulations, says Insp. Terkelsen. He reports they can easily avoid the government's penalty for delinquents—disqualification from further bidding on cutting rights—by simply changing their company name.

"This situation was much less prevalent when Forestry conducted all their own scaling," the policeman told the cabinet minister. His advice is that the regulations should require scalers to hand in their sheets to the government, and their scaling licences should be withdrawn if they fai He makes no suggestions about dealin with the stumpage-dodging creators of ne companies.

The RCMP investigation, following up complaint from Ministry of Forests sta dealt exclusively with the Small Busine Forest Enterprise Program, through whic 10% of the annual cut is sold to a high bic der who must be a small entrepreneu Small wonder, because Ministry of Fores officials admitted at recent hearings in the auditor-general's report that the devoted most of their monitoring activiti to that program, while ignoring the 90% the cutting done by the major, integrat forest companies. The majors, explaine the bureaucrats, could be checked b matching the stumpage paid against the own books.

But the auditor-general figures that th huge amount of stumpage now being pai is too great a temptation for the system rely on the trustworthiness of the industr Forestry firms may fudge their data, he su gests, and cut and mill or export the lo

# siness is on thin ice, imber should be

without ever reporting. On the basis of his accountants' snooping around the woods for a month, and finding several truckloads of logs unmarked by a scaler, he figures a loss of $25 million a year.

NDP MLA Bob Williams wonders if the figure might be four times that. A one-time Forests minister himself, he cites as evidence of what can happen when the industry is insufficiently policed the notorious Shoal Island case. This incident involved scalers working for British Columbia Forest Products (BCFP), since taken over by Fletcher Challenge Canada, consistently underestimating the volume of wood cut by independent contractors over several years in the late 1970s. Complaints by the contractors, and even evidence in the form of an independent scale showing a 10% undervaluation, failed to move either BCFP or the provincial government, which by implication was being underpaid in stumpage by 10%. The contractors won $1.5 million from BCFP in a mid-1980s settlement, but the court indicated the stumpage regulations were too vague to justify a B.C. government claim. In effect, these regulations stated that the stumpage due was whatever a properly licensed scaler said was due, although a scaler whose assessments didn't jibe with the ministry's check-scalers could lose his licence.

The government dismisses the Shoal Island fiasco as ancient history, and promises a slightly augmented staff reorganized into around-the-clock "log squads" to plug any holes. But the NDP is using the auditor-general's and RCMP reports to argue that, short-staffed and mismanaged as the Forests Ministry will still be, it will have no way of knowing whether Shoal Island is history or a current event.

*—Steve Weatherbe*

STEVE WEATHERBE

# Year in the forests

(Vancouver, BC) 10/8/90

## *As a recession hits, concern grows over B.C.'s timber supply*

Last week, the barons of British Columbia's forest industry gathered under the sails of the Vancouver Trade and Convention Centre for the 1990 Forest Sector Conference of the Council of Forest Industries (COFI). At the same time, the industry's largest union, the International Woodworkers of America-Canada, was holding its annual convention barely three blocks away. At both meetings, talk of a new era for the province's cornerstone industry emanated from the speaker's podium. On the floor, however, the talk was tinged with fear.

"We are into a very serious recession, possibly a depression," were IWA-Canada president Jack Munro's first words in his opening address to the union meeting. The evidence is hard to ignore. All across B.C., chainsaws lie idle, and mills have been reduced to one shift or shut down altogether. Profits have been halved in the last year. An estimated 4,500 jobs have been lost. Many see it as a repeat of the 1982 recession. Some fear it could be worse.

These concerns are not groundless. The last recession was triggered by a lack of demand. This time, not only has demand fallen again, but the industry is struggling with a host of other problems, from government policy to the availability of good trees. What is worse, these problems will not vanish when the current economic downturn ends.

Virtually every forest sector in every region of the province has been affected. Worst off are the lumber manufacturers, usually the first to enter a recession because interest rates peak at the end of a growth cycle, explains COFI's chief economist, Richard Bevan. The high cost of borrowing money discourages consumers from buying, building and adding on to their houses. When housing starts decline, lumber producers are in trouble. The North American housing market, which absorbs most of B.C.'s forest products, has been stagnant for more than a year.

As a result, producers are now cutting back. Weldwood of Canada Ltd closed its sawmill in Squamish on September 28, throwing 200 employees out of work. In Lillooet, Ainsworth Lumber has laid off 175. In Cranbrook, Crestbrook Forest Industries plans to lay off 60 workers for a two-month period beginning October 15. And near Kitimat, Weedene River Contracting Ltd has gone into receivership.

Faller: *Running out of trees to cut*

## The Cover

Even traditionally profitable, tenured mills [illegible] with secure log supplies are looking at more red ink than they did in the early 1980s. The Gorman Brothers Lumber mill in Westbank shut down for two weeks when the spring thaw turned into a washout last June. During the summer, when the company usually hires students to fill in for vacationing staff, the mill cut back to one shift. And one-week shutdowns are planned for October and December. "That adds up to six weeks (this year) we didn't run," says manager Ron Gorman. "We're not going to go broke, but it's tough all around."

Likewise, the outlook for plywood has gone from bad to worse. Tolko Industries expects to lay off at least 30 people at its Heffley Creek operation near Kamloops. Fletcher Challenge Canada will close its Fraser Mills plywood plant in Coquitlam next month and the company is trying to sell its Delta Plywood plant. Together they lost $15 million over the last few years, and their situation is not uncommon. Several south coast plywood plants have closed or changed hands. Employee-owned Richmond Plywood Corp is currently entertaining an offer from a mining company that intends to diversify.

Even value-added manufacturers, considered the future of the forest industry since they burst onto the scene in the mid-1980s, are suffering. Uneeda Wood Products of Chilliwack, Terminal Forest Products Ltd of Richmond, S & R Sawmills and Mill and Timber Products of Surrey have all made staff and production cutbacks.

Penticton's Greenwood Forest Products (1983) Ltd is down to one shift from two. Making interior wall panels for the do-it-yourself home improvement market, the company is not so dependent on stagnant housing starts, says president Peter Beulah Still, sales in Canada, the U.S. and United Kingdom are all off by one-third. "The consumer is scared. Nobody's buying the big-ticket items," he says. "We're still in our busy season now, but I worry about the winter."

The opposite applies to the Interior's independent loggers, who do most of their work in the winter months. "It's difficult to see how much the recession's hurt us," says Frank Denoghel, manager of the Central Interior Logging Association. Contractors are running at about half speed, but most of that is likely due to the B.C. Rail strike.

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### FORESTS

"We're never at full capacity at this time of year anyway," he observes. A better indication of the sector's strength will come in a few months' time.

In the rare position of running at full capacity without a strike, B.C.'s pulp and paper sector is only now feeling the pinch. The price of pulp peaked five months ago and is expected to fall up to 20% by next year with the general downturn in the North American economy, say industry analysts. The picture is brighter for the province's newsprint mills, which have no surplus paper lying around. The addition of new capacity at Port Mellon's Howe Sound Pulp and Paper and North Pacific Paper's plant at Longview, Washington, could force prices down next year, however.

But a cyclical market downturn is not the only reason for the hard times. The situation is exacerbated by the federal government's monetary policy, both the unions and the companies claim. By keeping interest rates high even as the economy takes a dive, the Bank of Canada not only quells house construction but also discourages forest firms from making capital improvements to increase their efficiency. Companies find it easier to shut a mill down if it is losing money. The high rate also inhibits the ability to make long-term investments in silviculture that may not pay off for 80 years. Without that sort of investment, everybody suffers.

More importantly, the high-interest-rate policy drives up the value of the Canadian dollar against other currencies, increasing the cost of doing business in this country accordingly. That does not matter much to businesses that serve a local market, since sales are in Canadian currency. But in the forest sector, where most of the product is exported, the price is set by an international marketplace. For Canadian producers, costs go up relative to those of competitors abroad, while returns stay the same.

"This recession was planned, an intended and deliberate goal of the policies of (the) federal government," labour leader Munro charges. And on this point he and industry executives are speaking the same language. Says mill manager Gorman, "Everything we're saying is falling on deaf ears."

And if Ottawa seems unwilling to do anything about the situation, Victoria is unable to, the industry fears. In 1982, the Ministry of Forests responded to the downturn with "sympathetic administration," an informal relaxation of environmental guidelines and other rules of doing business. Today, public opinion precludes any such move. Mills face stiffer pollution controls. Road building is more costly. And now forest companies must bear the full cost of reforestation within their tree farm licences.

But the most important change in provincial policy since the last recession involves stumpage, or the fee the Crown charges for trees cut on public land. The system in place during the early 1980s ensured that the Crown absorbed most of the fluctuation in forest products prices, says the ministry's timber pricing manager, Ken Baker. The price of trees was fairly uniform throughout B.C., averaging about $2.50 per cubic metre.

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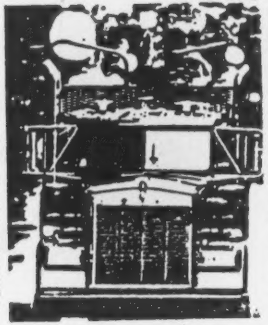
### FORESTS

Then three years ago, the United States—B.C.'s biggest customer—threatened to impose a countervailing duty against Canadian softwood lumber imports. The cheap stumpage system, the Americans reasoned, constituted an unfair trade advantage. The government of Canada responded with a 15% border tax on southbound exports. If a duty were going to be imposed, government leaders reasoned, Canada might as well be the ones to collect it.

The same line of thinking lay behind the province's move to raise stumpage rates to take the place of the border tax and satisfy the Americans our lumber was not subsidized. On October 1, 1987, a new system was implemented that was more sensitive to the quality and accessibility of the timber. The lowest grade of log costs 25 cents a cubic metre, the highest as much as $100. The average stumpage rate shot up to $8.50.

But then the forest sector was on the upswing, and few complained. Now the industry is grumbling about the new method's insensitivity to market conditions. But Mr. Baker says adjustments are being made. Because stumpage revenue effectively equals the old 15% border tax, every drop in lumber prices is followed with an equivalent fall in stumpage rates. The average rate has decreased since 1987, to $7.77 a cubic metre. "When companies complain about stumpage, they're harkening back to the days before the export tax," he adds.



Truck loggers: *The winter may be worse*

The time has come for the government to cancel its memorandum of understanding with the U.S. Department of Commerce to maintain the current stumpage system, argues NDP forests critic Daniel Miller. "It undermines our economic sovereignty. Our stumpage is essentially set by the United States," the former millwright says. Even with its flexibility, it represents a target revenue and thus

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nothing to respond to the needs of the industry.

Yet stumpage fees are far below the price of logs, especially high-grade logs, on the open market. Non-tenured mills find themselves in a bidding war over timber made available from private land and the Small Business Enterprise Program. Those that do get logs pay around $50 a cubic metre. Many simply cannot afford it and cease operations. This points to the last and most frightening of the forest industry's woes—a dwindling timber supply.

Among the cutbacks and layoffs announced in recent months was a 50% cut in production a Canadian Forest Products' stud mill in Taylor, starting next spring. Neither soft markets nor high interest rates were blamed for the cutback. The problem in this case is a lack of raw material. Canfor bought a mill in nearby Fort St. John nine years ago and spent $20 million upgrading it. The acquisition of the Taylor mill came last year when Canfor bought Balfour Forest Products and brought Canfor's sawmilling capacity in the area up to 1.2 million cubic metres a year. But Canfor's Allowable Annual Cut (AAC) in its forest licences in the area is only 700.000 cubic metres. On the log market, the company could obtain perhaps 200.000 more. One of the mills, therefore, had to be cut back. The older Taylor operation was the one, and about 100 jobs will be lost—permanently.

The picture is much the same throughout the Kamloops forest region, where sawmill capacity is an estimated 30% higher than the tree harvest. A similar situation is expected to develop in the Cariboo, as the region's nine-year program to wipe out forests infested with mountain pine beetle comes to an end. The Williams Lake forest district's AAC is expected to drop from 4.3 million cubic metres this year to 2.5 million next. Job loss in the logging sector is sure to be followed by cutbacks at the five sawmills in Williams Lake.

Until efforts at intensive silviculture come to fruition, the AAC can only shrink. Moreover, opening up of new areas is becoming less of an option, especially because the public continues to press for conservation, especially of virgin forest. As the first part of its Old Growth Strategy Project, the Ministry of Forests appointed a committee representing various interests to pinpoint areas where a strong argument could be made for preservation. In its report, released a month ago, the committee identified 17 old-growth stands where logging is to be deferred until further study is done on the old trees' importance to the surrounding ecosystem and human enjoyment. To the environmental movement, it wasn't enough. To the forest industry, it was 17 more areas out of commission.

The decline in the fibre supply is one of quality as well as quantity, notes Leslie Reed, who holds a forest policy research chair at the University of B.C. While the AAC has been falling at a rate of about 10% a decade since it was established in 1947, the real value of that timber has been dropping even faster. As the old growth disappears, so do most of the veneer and sawlogs. The industry in B.C. is shifting away from these products, towards pulp and specialty products.

A recession may serve to speed up the transition, and governments are unwise to interfere with the process, Dr. Reed argues. In the end, sympathetic administration served only to waste a lot of good wood, save few jobs and push more forest products onto an already glutted market, driving prices down further.

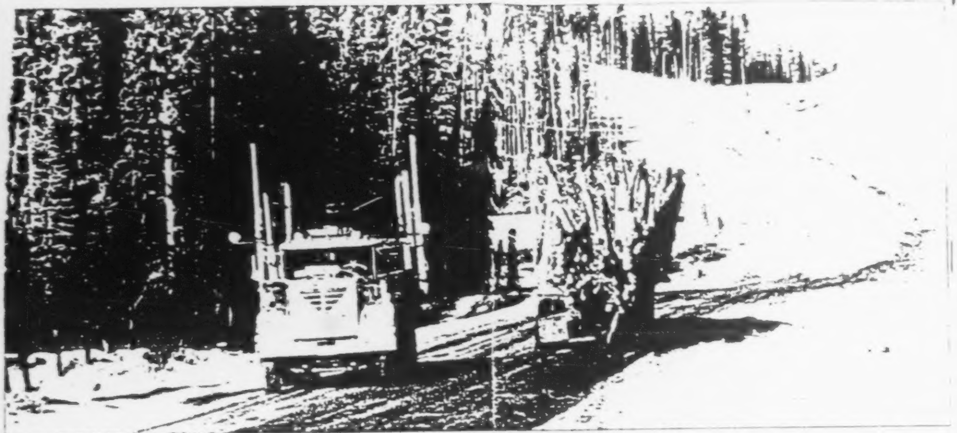
That does not mean forestry is a sunset industry. Statistics Canada figures show that employment in B.C.'s forest sector declined from 97.447 in 1979 to 79.028 in 1987. But those numbers do not include the small remanufacturers that cropped up in that period, Dr. Reed contends. "There's actually more employment out there in the forest industry than there used to be."

However fitfully, the industry *is* fulfilling its objective of getting more dollars and jobs out of fewer and less valuable trees. And, if anything, its competitors in the U.S. northwest face greater long-term obstacles in terms of demands for conservation and dwindling timber supplies. "I've seen eight or 10 recessions come and go," Dr. Reed says. The forest industry will adapt to the new realities and survive.

That is little consolation to those who depend on forestry for their livelihood, however. From their point of view, he says, "I worry about what's going to happen between now and Christmas."

*— Michael McCullough*

**Old-growth forest:** *Public pressure to preserve*



**Logging trucks in B.C.:** *Softwood exports have increased as producers find new markets*

# Hit hard by softwood?

## *The industry says it's hurting, but the stats say otherwise*

When it became apparent in late 1986 that an American lumber industry petition for a countervailing tariff against Canadian softwood was going to succeed, the Canadian government imposed a 15% export tax of its own on U.S.-bound softwood. That measure had the twin virtues of satisfying American lumber interests and ensuring that the 15% surcharge would wind up in Ottawa's coffers, not Washington's. The tax has since been replaced in British Columbia and Quebec by increases in stumpage fees (the price of logs sold by the provinces to the industry), netting the government of Premier William Vander Zalm an additional $300 million in annual revenues. Although the forest industry has long opposed the export tax, it kept its campaign muted pending the outcome of the free trade negotiations. Now that the trade deal is completed—without any change in the softwood-lumber agreement—the industry has launched its attack in earnest.

"It is our objective to see the agreement done away with," declares B.C. Council of Forest Industries spokesman Allan Sinclair. "It violates the ability of B.C. to establish a flexible stumpage system that is responsive to market factors and allows industry to re- [illegible] competitive."

[illegible] last month, the Canadian Lumbermen's Association issued a report noting that the Canadian share of the U.S. softwood-lumber market has dropped from a high of 33% in 1986 to 28% last year. The association blames the memorandum of understanding signed by Canada and the U.S. at the end of 1986, which it believes is making Canadian softwood lumber uncompetitive with the U.S. product. "We've been preaching this for two years now and the effect was muted because of the strong markets we had in 1987 and 1988," says association president James Hickey. "But now it's coming home to roost in 1989."

Armed with predictions of declining housing starts and a rising Canadian dollar, industry spokesmen paint a grim picture of production cutbacks and layoffs in their arguments to overturn the softwood lumber agreement. The numbers, however, are far from conclusive. The latest Statistics Canada figures indicate a significant increase in both Canadian and B.C. lumber production during the first year of the agreement, with a slight decline during the past year. Canadian softwood exports to the U.S. dropped marginally from 11.4 billion board feet in the first nine months of 1986 to 11.1 billion board feet during the same period in 1988. Total softwood exports increased signifi- [illegible] however, indicating that many producers have found new markets outside the U.S. Total Canadian softwood-lumber exports were 13-billion board feet in the first nine months of 1986, rising to 14-billion board feet in the corresponding period in 1988.

NOT SURPRISINGLY, some industry observers are critical of the complaints. "The solution, if [the Council of Forest Industries] wants a market-based stumpage system, would be to develop a real market," declares New Democratic Party Forest critic Dan Miller, echoing complaints from both U.S. lumber producers and small, independent B.C. loggers that competition has been eliminated from the B.C. woods since control of the timber supply has become concentrated in the hands of a few large, integrated forest companies which are not required to compete for the public timber they buy.

In its report the lumber association predicts a 5.5% decline in U.S. housing starts during 1989 and a similar decline in Canada, leading to a projected 9% decrease in Canadian lumber production over the coming year. But a survey of U.S. consumer confidence released in the new year by a business-financed research organization, the Conference Board of Canada, reports that American consumers are more confident about the economic situation than they have been since the late 1960s. According to the Conference Board, they plan to sustain the spending spree they have been on for the past two years—and that will include the purchase of new homes.

—Ken Drushka